IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

TAX APPEAL No 273 of 2002
with
TAX APPEALS NOS. 285, 286, 299 and 348 of 2002
with
TAX APPEALS NOS. 374, 375, 376, 377, 381 & 382 of 2002
with
TAX APPEALS NOS. 383, 384, 385, 359, 360 & 362 OF 2002
with
TAX APPEALS NOS. 128, 129, 195, 196, 197, 198, 199, 257, 258, 259, 300, 361, 380 of 2002
with
TAX APPEALS NOS. 22 and 23 of 2003

For Approval and Signature:

Hon'ble MR.JUSTICE R.K.ABICHANDANI
and
Hon'ble MR.JUSTICE A.L.DAVE

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : YES

2. To be referred to the Reporter or not? : YES

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the concerned Magistrate/Magistrates,Judge/Judges,Tribunal/Tribunals? : NO

COMMISSIONER OF INCOME TAX (Appellant in all Appeals)

Versus

VIJAY SHIP BREAKING CORPN (Respondent in Tax Appeal No. 273 of 2002)

M/S. ANNAPURNA SHIP BREAKERS (Respondent in Tax Appeal No. 374 of 2002)

M/S. GAUTAM SHIP BREAKING INDUSTRIES (P) LTD.(Respondent in Tax Appeal Nos. 375 & 376 of 2002)

M/S. BHARAT SHIP BREAKERS CORPORATION (Respondent in Tax Appeal No. 377 of 2002)
M/S. TRIVENI SHIP BREAKING (Respondent in Tax Appeal No. 380 of 2002)
M/S. MADHAV INDUSTRIAL CORPORATION (Respondent in Tax Appeal No. 381 of 2002)
M/S. WESTERN SHIP BREAKING CORPORATION (Respondent in Tax Appeal Nos. 199, 259, 286, 382 of 2002 & Tax Appeal Nos. 22 and 23 of 2003)
M/S. SHIP TRADE CORPORATION (Respondent in Tax Appeal No. 383 of 2002)
M/S. MADHAV STEELS (Respondent in Tax Appeal 384 of 2002)
M/S. SHIP TRADE CORPORATION (Respondent in Tax Appeal Nos. 359 & 385 of 2002)
M/S. GAUTAM SHIP BREAKING IND. (P.) LTD. (Respondent in Tax Appeal No. 285 of 2002)
M/S. SHIRIJI TRADERS (Respondent in Tax Appeal No.299 of 2002)
M/S. A.G. SCRAP CORPORATION (Respondent in Tax Appeal No. 300 of 2002)
M/S. BHARAT SHIP BREAKING CORPORATION (Respondent in Tax Appeal Nos. 257, 258 & 361 of 2002)
MADHAV INDUSTRIAL CORPORATION (Respondent in Tax Appeal Nos. 128 & 129 of 2002)
M/S. APPOLLO VIKAS STEEL PVT. LTD. (Respondent in Tax Appeal Nos.195, 196, 197 & 198 of 2002)
M/S. PRIYA BLUE INDUSTRIES PVT. LTD. (Respondent in Tax Appeal Nos. 360 & 362 of 2002)
M/S. MAHALAXMI SHIP BREAKING CORPORATION (Respondent in Tax Appeal No. 348 of 2002)

Appearance:
MR.MIHIR JOSHI, MR.PRANAV G.DESAI MR. TANVISH U. BHATT ADVOCATES - in all the appeals for the Revenue
MR. P.CHIDAMBARAM, SR.ADVOCATE WITH MR.S.N.SOPARKAR, SR. ADVOCATE FOR MRS SWATI SOPARKAR, ADVOCATE, MR.K.H.KAZI, MR. K.C.PATEL, SR. ADVOCATE, MR.R.K.PATEL, MR.BHARGAV KARIA, MR. M.K. PATEL, MR. MANISH KAJI, MR.TUSHAR HEMANI Advocates - in respective appeals for the assessees
MR.J.P.SHAH, Advocate, as intervener.

CORAM : MR.JUSTICE R.K.ABICHANDANI
and
MR.JUSTICE A.L.DAVE

Date of decision: 20/03/2003

ORAL JUDGEMENT

I. Questions of law involved in these appeals (Para-1).

II. Brief facts (Paras 2 to 6).

III. Contentions and cases cited for the Revenue (Paras 7 and 7.1).

IV. Contentions and cases cited for the Assessees (Paras 8 and 8.1).

V. Reasoning (Paras 9 to 27).

VI. Decision (Paras 28 to 30).

(Per : MR.JUSTICE R.K.ABICHANDANI for the Court)

1. This group of 32 matters has been argued together having regard to the nature of controversy and the common questions of law involved, which are as under :

I. QUESTIONS OF LAW INVOLVED IN THESE APPEALS:

1. In Tax Appeal No. 273/2002:-

[1] Whether the usance interest paid by the assessee apart from the purchase price of the ship would fall within the scope of definition of term `interest' u/s. 2[28A] of the Income Tax Act, 1961?

[2] Whether the Appellate Tribunal was right in law and on facts in deleting the disallowance under section 40[a][i] of the Act for the failure on the part of the assessee to deduct tax at source from usance interest paid to a non-resident under section 195[1] of the Act?

[3] Whether the Appellate Tribunal was right in law and on facts in holding that usance interest partakes the character of purchase price and therefore not liable to deduction at source u/s 195[1] of the Act?

[4] Whether the Appellate Tribunal was right in law and on facts in allowing the deduction u/s 80HH and 80I to the

assessee holding that ship breaking activity gives rise to manufacture and production of altogether a new article or thing?

In Tax Appeal Nos. 285, 286, 299 and 348 of 2002:-

[1] Whether the usance interest paid by the assessee apart from the purchase price of the ship would fall within the scope of definition of term `interest' u/s 2[28A] of the Income Tax Act, 1961?

[2] Whether the Appellate Tribunal was right in law and on the facts in deleting the disallowance under section 40[a][i] of the Act for the failure on the part of the assessee to deduct tax at source from usance interest paid to a non-resident under section 195[1] of the Act?

[3] Whether the Appellate Tribunal was right in law and on facts in holding that usance interest partakes the character of purchase price and therefore not liable to deduction at source u/s 195[1] of the Act?

In Tax Appeal Nos. 374, 375, 376, 377, 381 and 382 of 2002:-

[1] Whether the usance interest paid by the assessee apart from the purchase price of the ship would fall within the scope of definition of term `interest' u/s 2[28A] of the Income Tax Act, 1961?

[2] Whether the Appellate Tribunal was right in law and on facts in deleting the disallowance under section 40[a][i] of the Act for the failure on the part of the assessee to deduct tax at source from usance interest paid to a non-resident under section 195[1] of the Act?

[3] Whether the Appellate Tribunal was right in law and on facts in holding that usance interest partakes the character of purchase price and therefore not liable to deduction at source u/s 195[1] of the

Act?

[4] Whether the Appellate Tribunal was right in law and on facts in holding that `usance interest' is not interest as envisaged in the Double Taxation Avoidance Agreement?

In Tax Appeal Nos. 383, 384, 385, 359, 360 and 362 of 2002:

[1] Whether the usance interest paid by the assessee apart from the purchase price of the ship would fall within the scope of definition of term `interest' u/s 2[28A] of the Income Tax Act, 1961?

[2] Whether the Appellate Tribunal was right in law and on facts in deleting the disallowance under section 40[a][i] of the Act for the failure on the part of the assessee to deduct tax at source from usance interest paid to a non-resident under section 195[1] of the Act?

[3] Whether the Appellate Tribunal was right in law and on facts in holding that usance interest partakes the character of purchase price and therefore not liable to deduction at source u/s 195[1] of the Act?

[4] Whether the Appellate Tribunal was right in law and on facts in holding that `usance interest' is not interest as envisaged in the Double Taxation Avoidance Agreement?

[5] Whether the Appellate Tribunal was right in law and on facts in allowing the deduction u/s 80HH and 80-I to the assessee, holding that ship breaking activity gives rise to manufacturing and production of altogether a new article or thing?

In Tax Appeal Nos. 128, 129, 195, 196, 197, 198, 199, 257, 258, 259, 300, 361, 380 of 2002 and Tax Appeal Nos. 22 and 23 of 2003:

Whether the Appellate Tribunal was right

in law and on facts in allowing the deduction u/s 80HH and 80-I to the assessee, holding that ship breaking activity gives rise to manufacturing and production of altogether a new article or thing?

II. BRIEF FACTS:

2. The Tax Appeals Nos. 273 of 2002 and 196 of 2002 have been argued as the lead matters. This is because the main judgement of the Tribunal from which the first three questions of law raised in Tax Appeal No. 273 of 2002 arise has been followed by the Tribunal in other matters and the substantive judgement which has been rendered on the fourth question which is a sole question in Tax Appeal No. 196 of 2002 has been decided by the Tribunal in the order from which that appeal arises which has been followed by the Tribunal in other matters.

3. The learned counsel for the appellant - Revenue have filed paperbook in Tax Appeal No.273 of 2002. The learned counsel for the respondents - assessees have also filed common paperbook in Tax Appeal No.273 of 2002 and separate paperbook Nos.1 and 2 in Tax Appeal No. 348 of 2002, Tax Appeal No.196 of 2002 and a compilation in Tax Appeal No.196 of 2002. All the learned counsel have argued all these appeals referring to the record of the Tax Appeal No. 273 of 2002 and Tax Appeal No. 196 of 2002 and these paperbooks and have stated that all other appeals involve identical points since the Tribunal has decided those matters on the basis of its detailed orders made in these two appeals. We would therefore discuss the facts with reference to the record of these two appeals.

4. The assessee firm was engaged in the business of ship breaking at Alang Port during the previous year relevant to the A.Y. 1995-96. Old and condemned ships were acquired by the assessees for demolishing purpose. The two ships which were purchased by the assessee for breaking purposes were MV Krasnozarodsk and M.V.Global Hope. Krasnozarodsk was purchased by the assessee from M/s Electra Maritime (Jersey) Ltd., London under Memorandum of Agreement (MOA for short) dated 15th March 1993 for a total purchase price of the ship which was agreed at US $ 901252.98 calculated at the rate of US $ 184.5 per long ton of LDT. It appears that the ship was manufactured in 1965 in Finland. In the MOA, credit for 180 days usance period from the date of physical delivery of the vessel at safe anchorage Alang was agreed and rate

of interest was stipulated in para 2 thereof flat at 6% per annum. The other vessel M.V. Global Hope was purchased by the assessee from M/s Neter Navigator, Singapore under MOA dated 14th July 1994 for the total purchase price which was agreed at US $ 3069416.5 calculated at the rate of US $ 166.06 per long ton. The ship appears to have been manufactured in U.K. in 1969. Interest was stipulated to be paid at 7.25% from the date of notice of release for 180 days of usance period worked out on the purchase price of the ship. In both the cases the amounts were to be paid by means of irrevocable 180 days usance letter of credit (L.C.) as in all other cases.

4.1 During the course of scrutiny proceedings, the assessing officer (Assistant Commissioner of Income Tax, Central Circle 1, Rajkot) observed that, as per the terms of the MOA, the assessee was making interest payment to the non-resident parties on account of credit facility availed by it for the purchase of the ships. Therefore, he raised queries by letter dated 2nd January 1998 inquiring as to whether tax was deducted at source on such interest payments and if it was not so deducted, then calling upon them to show as to why the provision of section 40(a)(i) of the Income Tax Act, 1961 ("the Act" for short) should not be invoked in the assessee's case and why the entire interest paid outside India should not be disallowed in the course of assessment. After considering the submissions made by the assessee and the material on record, the assessing officer negatived the contention of the assessee that both the principal amount of the purchase price of the ship and the interest amount paid on the usance credit constituted the purchase price of the ship. It was held that the purchase price of the ship was separately mentioned in the MOA and that the usance interest amount which was also separately mentioned was not part of the purchase price. The officer held that any other view would be illogical because if the contention of the assessee is to be accepted, then it would lead to a situation where as soon as the delivery of the vessel was made, the seller would get the price of the vessel plus the usance interest of 180 days though the usance period would be counted only after the date of delivery. It was held that the purchase price of the vessel and the usance interest were two distinct items of payment. It was also held that the reliance by the assessee on the decision of the Andhra Pradesh High Court in C.I.T. v. Vishakhapatanam Port Trust, reported in 144 ITR 156 was misconceived, because, that decision was given in respect of the A.Y.s 1970-71 to 1974-75 when the term "interest" had not been defined

in the Act. It was noticed that, in the Andhra Pradesh case, as per the Double Taxation Avoidance Treaty (with Germany), which had an overriding effect on the Act, interest, in the case of non-resident was chargeable in India only if it was found to be arising out of indebtedness. The assessing officer held that, in the instant case, interest was defined under section 2(28A) to include payment of interest on any claim or obligation. The decision of this Court in C.I.T. v. Saurashtra Cement & Chemicals Ltd., reported in 101 ITR 502, was also held not to apply to the assessee's case since, in that case which was relatable to the provisions of section 9(1)(i) of the Act, the issue before the Court was whether there was any business connection of the non-resident with the assessee. In that case, the agreement had been signed outside India, and delivery and payment had been taken outside India. The assessing officer held that whatever principal amount or interest amount was paid as per the MOA to the non-resident through the bank by means of letter of credit was paid on behalf of the assessee. Therefore, the contention that the payment was made to the bank in India and not to the non-resident seller was negatived. The assessing officer, therefore, by his order dated 30th march 1998 disallowed the expenditure of usance interest payment under the provisions of section 40(a)(i) of the said Act in respect of both the ships. In the same order, he considered the assessee's claim of deduction under Sections 80HH and 80I of Rs.21,23,798 made on the ground that the assessee was an industrial undertaking engaged in the activity of manufacture. The assessing officer held that ship breaking would not constitute any manufacturing activity. Applying the ratio of the decision of the Supreme court in C.I.T. v. N.C.Budhdharaja, reported in 204 ITR 412, it was held that ship breaking did not constitute any activity of manufacturing or production.

5. The order of the Assistant Commissioner of Income Tax was challenged by the assessee before the C.I.T. (Appeals), VI, Ahmedabad, who while confirming the said order, held that the interest was payable by the assessee to the non-resident on debts incurred by deferring payment of purchase consideration in respect of the two ships for the purpose of its business carried on in India. It was held that the Double taxation Avoidance Agreement between the Government of India and the Government of U.K. and Singapore provided for taxation of interest income even in the country of the resident which in the present case was India and that interest income from debt claims of any kind could be so taxed in

India. It was held that the amount of interest paid by the assessee to the non-resident concerns were liable to deduction of tax at source under Section 195(1) of the Act and since the assessee had failed to deduct the amount of such tax, the assessing officer had correctly applied the provisions of section 40(a)(i) of the Act for disallowing the claim of interest of Rs.42,52,767.

5.1 The CIT (Appeals) noted that the assessee had debited the purchase price of the ships as was mentioned in the MOA in its books of account and the liability for the interest amount mentioned in the MOA had been separately claimed as revenue expenditure. It was also noted that the purchase consideration excluding interest had been disclosed to the customs authorities for payment of the customs duty. It was held that if interest paid by the assessee to the non-resident concerns for availing of the credit facility for payment of the purchase consideration was also a part of the purchase consideration, the assessee would have been charged customs duty on the interest element also. It was further held that the material showed that both the sale consideration as well as interest thereon had been shown as receipt by the seller from the assessee and therefore, even if the bills under letters of credit were discounted by the sellers earlier than the stipulated 180 days for their usance period, the sellers would have debited the discounting charges paid to the bank in their profit and loss account, because, the interest amount in addition to the purchase consideration had been shown as received by them. On the question of claim of the assessee under section 80HH and 80I, the CIT (Appeals) held that such deduction was not available to the assessee because, the ship breaking was not in the nature of a manufacturing activity.

6. The assessees carried the matter to the Tribunal against the order dated 6-6-2000 made by the CIT (Appeals). The Tribunal held that the purchase of a ship was a single transaction for which the agreement was entered into and although the purchase price of the ship and usance interest for 180 days from the date of the delivery/NOR were separately mentioned in the MOA, nonetheless it remained a single transaction of purchase and sale of the ship. Moreover, the buyer had to make payment of the total amount which was inclusive of interest by letter of credit. It was held that the interest amount though separately mentioned in the MOA was part of the same transaction and cannot be meted out a separate treatment from the main component i.e. the purchase price. The Tribunal observed: "In other words,

the point we are trying to drive home is that what governs a purchase transaction, will also govern the component thereof. It also needs to be appreciated that there is no right of pre-payment by the buyer to the seller, that is to say, irrespective of the point of time when the buyer makes payment within 180 days, the buyer shall have to pay the interest component as specified in the MOA". The Tribunal concluded that, by entering into MOA, the buyer did not incur any debt in the sense of raising any loan or advance so as to be indebted to the sellers, and that it was a pure and simple purchase transaction in terms of the L.C. for the total amount including interest. It was further held that, in the present case, the purchase price and interest payable were arising from the same source i.e. the transaction entered into with the buyer for sale of ship and not from two different sources. On this basis, the Tribunal concluded that the interest amount though separately mentioned in the MOA and described as "interest" therein, partook the character of the purchase price for the buyer and should be treated as purchase price. According to the Tribunal, its view point was strengthened from the provisions of the DTAA, under which as per the definition of the term "interest", each and every debt was not envisaged to be included in the terms "debt claims" referred to in the definition of "interest". It was held that the expression "debt claims" will take colour from the associated terms used in the definition namely bonds, debentures etc, and that the term "interest" under the DTAA was meant to be interest earned on government securities, bonds etc. It was held that, in the present case, there was no intention between the parties to raise any loan and pay interest thereon. It was noted that the treaties with Indonesia and Philippines specifically included deferred payment of sales while referring to debt claims. The Tribunal placed reliance on the decision of the Andhra Pradesh High Court in Vishakhapatanam Port Trust case (supra) and held that the assessee was not liable to deduct tax at source from the payment of interest to the non-resident and hence, the disallowance of interest made under Section 40(a)(i) was not warranted.

6.1 On the question of the claim of the assessee for deduction under Section 80HH and 80I of the Act, the tribunal relying upon the decision of the Bombay High Court in Ship Scrap Traders v. CIT and Virendra & Co. reported in 251 ITR 806, held that ship breaking results in production of articles and amounts to manufacture, and that deduction should be allowed to the assessee under Section 80HH and 80I of the Act.

III CONTENTIONS AND THE CASES CITED FOR THE REVENUE:

7. The learned counsel for the appellant - Revenue contended that, under the M.O.A., payment of interest for the usance period was to be made separately to the non-residents in all these cases. This created a liability on the part of the residents making such payment by means of L.C. to deduct tax at source under Section 195(1) of the Act. If at all according to them no tax was to be deducted, then the proper course was to follow the procedure laid down under Section 195 itself, and there was no option on the part of the residents not to deduct tax from the interest which was payable to the non-residents at the time of making credit to their account or making payment by any mode including by letter of credit, whichever was earlier. It was submitted that the letter of credit was just an arrangement by which the price of the goods and interest on the late payment of the price over the period of 180 days was paid by the buyer to the seller in discharge of his contractual obligations. It was submitted that, interest is income which was chargeable to tax and the interest payable by the resident to the non-resident would be deemed to be arising in India under Section 9(1)(v) of the Act irrespective of the manner in which it may have been paid or wherever it may have been paid. It was also argued that there were ample safeguards in sections 195 and 197 to prevent double taxation and requisite order could be obtained determining whether tax was deductible on such payment, or certificate could be obtained allowing payment of interest to the non-resident without deduction of tax. It was submitted that the payment of the amount of purchase price and interest under the L.C. discharged the underlying debt in respect of the sale of the ship. The learned counsel, therefore, argued that since no deduction was made by the assessees as required by the provisions of section 195(1) nor any order or certificate obtained so as to justify the non-deduction, they were not entitled to deduct the interest amount while computing the income chargeable under the head "profit and gains of business income" in view of the provisions of Section 40(a) of the Act. It was also submitted that where in respect of any such sum tax has been paid or deducted in any subsequent year under Chapter XVII(B), such sum shall be allowed as deduction in computing the income of the previous year in which such tax has been paid or deducted, as per the proviso to Section 40(a). It was, therefore, submitted that no prejudice was caused to the assessee if the provisions were complied with even later on. It was pointed out that tax deduction at

source was one of the ways contemplated by section 4(2) of the Act for recovery of tax in respect of the income chargeable under sub-section (1) thereof besides the mode of advance payment. It was argued that shipbreaking was neither a manufacture nor production of any article or thing.

7.1 The learned counsel, in support of his contentions, relied upon the following decisions :

[a] In Bombay Steel Navigation Company v. C.I.T., reported in 56 ITR 52, in a case where the parties had agreed that assets of the value of Rs.81,55,000=00 be taken over by the assessee company and out of that consideration, Rs.29,99,000=00 were paid by the assessee company and the balance remained unpaid for which interest was to be paid, it was held that an agreement to pay the balance of consideration due by the purchaser does not in truth give rise to a loan. The Supreme Court held that a loan of money undoubtedly results in a debt, but every debt does not involve a loan. Liability to pay a debt may arise from rival sources, and the loan is only one of such sources.

[b] The decision in Agarwal Chamber of Commerce Ltd. v. Ganpatrai Hiralal, reported in 33 ITR 245 was cited to point out that, in context of the provisions of section 40(2) of the Indian Income Tax Act, 1922, the Supreme Court held that, under the said provision which was essentially a machinery and enabling section, the tax to be realized from a non-resident could be levied upon the agent in the same manner as it could have been levied upon and recovered from a non-resident. It was held that the Hapur firm being an agent could be held liable under Section 40(2) and 42(1) of the Act of 1922 as an assessee for income tax on the profits made on the respondents' transactions at Hapur and was therefore entitled under the proviso to section 42(1) to retain the estimated amount of income tax payable on the amount of respondents' profits which, in that case, were deducted, retained and actually paid. The Court held that if the Hapur firm rightly paid the tax on the profits, the respondents cannot be allowed to challenge the amount on the ground that his total world income was not taxable and he was entitled to his

profits without deductions. That was a question which had to be agitated by the non-resident assessee at the time of his assessment. It was held that those persons who are bound under the Act to make deductions at the time of payment of any income, profits or gains are not concerned with the ultimate result of the assessment.

[c] The decision of the Delhi High Court in J.K.Synthetics Ltd. v. Assistant Commissioner of Income Tax, reported in 185 ITR 540 which was rendered in context of the provisions of sections 9(1)(v) and 195(2) of the said Act, was cited for the proposition that the interest payable to the foreign supplier of raw material was deemed by section 9(1)(v) to accrue or arise in India and the proviso to section 195(2) made section 195(2) inapplicable in such case. In that case, the petitioner had to remit interest to a foreign supplier of raw material which it claimed was exempt from tax in the provisions of section 10(15)(iv)(c) of the said Act. The petitioner applied for exemption from deduction of tax at source. That application came to be rejected and the petitioner challenged the order refusing exemption. It was held that the application for grant of a certificate of exemption from deduction of tax at source could not have been made under any other provisions of the Act except section 195(2), and that the respondent was right in declining to grant any exemption certificate to the petitioner.

[d] The decision of the Supreme Court in Transmission Corporation of A.P. Ltd. and another v. C.I.T., reported in 239 ITR 587, which was rendered in context of the provisions of section 195 of the said Act, was cited for the proposition that the purpose of sub-section (1) of section 195 is to see that, on the sum which is chargeable under Section 4 of the Act, for levy and collection of income tax, the payer should deduct income tax thereon at the rates in force, if the amount is to be paid to a non-resident. The said provision is for tentative deduction of income tax thereon subject to regular assessment and by the deduction of income tax, the rights of the parties are not, in any manner, adversely affected. Further, the rights of the payee or recipient are fully safeguarded under Sections 195(2), 195(3) and

197. The only thing which is required to be done is to file an application for determination by the assessing officer that such sum would not be chargeable to tax in the case of the recipient, or for determination of the appropriate proportion of such sum so chargeable, or for grant of certificate authorizing the recipient to receive the amount without deduction of tax, or deduction of income tax at any lower rate. On such determination, tax at the appropriate rate could be deducted at the source. If no such application is filed, income tax on such sum is to be deducted and it is the statutory obligation of the person responsible for paying such "sum" to deduct tax thereon before making payment.

[e] The decision of the Bombay High Court in C.I.T. v. Vishnudayal Dwarkadas, reported in 123 ITR 140 was cited to point out that, in a case where under the agreement between the parties, the entire price, both for the moveable and immovable properties, agreed to be sold, was to be paid to the assessee by the vendor on May 1, 1958, and since the purchaser was unable to pay the same on that date, and paid it on the execution of the sale deed, on January 25, 1959, the sum of Rs.15,083=00 was paid by way of interest, it was held that this amount was not part of the purchase price, but was a payment by way of interest and constituted a revenue receipt in the hands of the assessee. The Court rejected the contention that the amount of interest was part and parcel of the sale price.

[f] The Supreme Court, in Keshuram Industries & Cotton Mills Ltd. v. Commissioner of Wealth Tax, reported in 59 ITR 767, while considering the definition of the word "debt" and noticing the judgements which were cited at the Bar, held that there was no conflict on the definition of the word "debt", and that all the decisions agreed that the meaning of the expression "debt" may take colour from the provisions of the concerned Act; it may have different shades of meaning. It was held that the definition of word "debt" to the effect that a debt is a sum of money which is now payable or will become payable in future by reason of a present obligation; "debitum in praesenti solvendum in futuro" was unanimously accepted. The Supreme Court also held that in the expression "debt owed", the verb

"owe" means " to be under an obligation to pay", and it does not really add to the meaning of the word "debt".

[g] The decision of the High Court of Justice (King's Bench Division) in Hudson's Bay Company v. Thew (Surveyor of Taxes), reported in VII Tax Cases, 206 was cited to point out that, in a case where the company entered into an agreement with purchaser unable to provide the whole purchase money in one sum, under which the purchaser was to pay certain sum down when the contract was signed and the balance by equal annual installments, each with interest calculated on the balance of the purchase money remaining unpaid, and it was argued that this interest which was interest paid in respect of their forbearing to collect for a certain time their purchase money, that is interest on unpaid purchase money was not income, Rowlatt, J. negativing the contention held that, "They have got a covenant from the purchaser to pay the purchase money and he remained debtor to them for the purchase money; but until he pays it, he pays interest; if they had collected the money and had been paid it, they would have invested it and got interest. The purchaser has not paid it, and he therefore pays interest instead until he does pay it. It is no good repeating myself, but I cannot see why that is not interest but is capital".

[h] The decision of Court of Appeal in United City Merchants (Investments) Ltd. and others v. Royal Bank of Canada, reported in (1981) 3 All. E.R. at page 142, was cited for the proposition that the Letter of Credit is regarded as almost equivalent to cash in the seller's hand. It is his guarantee that payment for his goods will not be held up by the buyer on some pretext as to their quality. The holder of an irrevocable letter of credit need not fear that he may have to bring an action to recover the price and be met with a specious counter claim that enables the buyer to get leave to defend and so keep him out of his money for the months or years that may pass before the action can be brought to trial. The seller can use the letter of credit to finance other business; it is, as has been said more than once, part of the life blood of commerce. (Griffiths LJ at page 151 of the report). The Court of Appeal cited with approval

"a classic passage" of the judgement of Jenkins LJ in Malah (Trading as Hamzeh Malas & Sons) v. British Imex Industries Ltd., reported in (1958) 1 All E.R. 262 at page 263, in which it was stated that the opening of a confirmed letter of credit constituted a bargain between the banker and the vendor of the goods, which imposed on the banker an absolute obligation to pay, irrespective of any dispute which there may be between the parties whether the goods are upto contract or not. It was held that an elaborate commercial system had been built up on the footing that the banker's confirmed credits are of that character, and, it would be wrong to interfere with that established practice. It has to be remembered that a vendor of goods selling against the confirmed letter of credit is selling under the assurance that nothing will prevent him from receiving the price. That is of no mean advantage when goods manufactured in one country are being sold in another.

[i] The decision of the House of Lords in Riches v. Westminster Bank Ltd., reported in (1947) A.C. 390 was cited to point out that, it was held therein that the essence of interest is that it is debt. It is a payment which becomes due because the creditor has not had his money at the due date. The House of Lords negatived the contention that the sum in question could not be interest at all because interest implies a recurrence of periodic accretions, whereas the sum came to existence uno flatu by the judgement of the court and was fixed once for all, holding that, in truth, the sum represented the total of the periodic accretions of interest during the whole time in which payment of the debt was withheld. The sum awarded was the summation of the total of all the recurring interest items. (Lord Wright at page 403 of the report). Viscount Simon observed: "But I see no reason why, when the judge orders payment of interest from a past date on the amount of the main sum awarded (or on a part of it), this supplemental payment, size of which grows from day to day by taking a fraction of so much per cent per annum of the amount on which interest is ordered, and by the payment of which further growth is stopped, should not be treated as interest attracting income tax. It is not capital, it is rather the accumulated fruit of a tree which the

tree produces regularly until payment".

[j] The decision of House of Lords in Chancery Lane Safe Deposit and Offices Co. Ltd. v. Inland Revenue Commissioners, reported in (1966) 1 All E.R. 1, was cited to point out that, it was held that the income tax deducted from so much of the interest as the appellant had debited to capital must be accounted for to the revenue because the appellants calculated and maintained decision to attribute part of the interest payments to capital which precluded a contrary and inconsistent attribution. It was held that the decision to attribute part of the interest payments to capital was one that had produced practical results inconsistent with an allocation of the sum to revenue and accordingly, bound the appellants.

[k] The decision of the Madras High Court in Commissioner of Income Tax Vs. C.C.C. Holdings, reporting in (2003) 127 Tax Man 281 (Mad) was cited to point out that, in a case where the assessee claimed deduction of interest payment to a foreign banker from its business income, and it was contended that the interest payment was towards the amount lent outside India, and therefore, interest accrued outside India and not taxable in India, the High Court held that the person who claims the benefit under the provisions of the Act, has to prove before the authorities that he is entitled to the benefit of deduction by placing proper and sufficient material to that effect. In the absence of any such materials, the authorities under the Act cannot grant any relief based on presumption. The Court noticed that the Income Tax Officer had found from the profit & loss account of the assessee company that the assessee had debited to its profit & loss account a sum of Rs.3,17,805=00 being the interest amount which the assessee owed to the collecting foreign banker. The assessee had not produced any material to disprove its own entry or to show that the interest was not paid to a non-resident to take it out of the ambit of section 40(a)(i) of the Income Tax Act inasmuch as the said provision provided that the interest shall not be deductible item in the computation of total income if the tax payable has not been deducted at source under Chapter XVII-B of the Income tax Act.

[l] In W.J. Alan & Company Ltd. v. El Nasr Export & Import Co., a decision of the Court of Appeal, reported in Lloyds Law Reports (1972) Vol. I at page 313 = (1972) 2 All England Reports 127, Lord Denning M.R. after analyzing the effect of a letter of credit, held that in the ordinary way, when the contract of sale stipulates for payment to be made by confirmed, irrevocable letter of credit then, when the letter of credit is issued and accepted by the seller, it operates as conditional payment of the price. It does not operate as absolute payment. It is analogous to the case where under a contract of sale, the buyer gives a bill of exchange or a cheque for the price. It is presumed to be given, not as absolute payment, nor as a collateral security, but as conditional payment. If the letter of credit is honoured by the bank, when the documents are presented to it, the debt is discharged. If it is not honoured, the debt is not discharged and the seller has a remedy in damages against both the banker and buyer.

[m] Decision in V.S.T. Industries v. Collector of Central Excise, Hyderabad, reported in 1998(97) ELT 395 (SC) was cited to point out that, in paragraph 11 of the judgement, after considering its earlier decision in Madras Rubber Factory, the Supreme Court held that when goods were sold on credit and interest is received, that does not form part of the price on which excise duty is payable.

[n] Decision in Devidas Vithaldas & Co. v. Commissioner of Income Tax, Bombay City I, reported in 84 ITR 272 was cited for the proposition that if the transaction is embodied in a document, the liability to tax depend upon meaning and content of the language used in it accordance with the ordinary rules of construction.

[o] Decision in K.P.Subbarama Sastri v. K.S.Raghavan, reported in (1987) 2 SCC 424, was cited for the proposition that, where a contract provides for payment of money in installments and contains also a stipulation that on default being committed in paying any of the installments the whole sum shall become payable at once, the true

test for determining whether the said condition is in the nature of a penalty is to find out whether the amounts referred to in the agreement were debita in praesenti although solvenda in futuro or whether they were to become due to the promisee only on the respective dates when the installments were payable. It was held that if on a proper construction of a contract it is found that the real agreement between the parties was to the effect that the whole amount was on the date of the bond a debt due but the creditor for the convenience of the debtor allowed it to be paid by installments intimating that if default should be made in the payment of any installment, he would withdraw the concession, then the stipulation as to the whole amount of the balance becoming payable would not be penal.

[p] Decision of the Bombay High Court in Narsee Nagsee & Co. v. Commissioner of Income Tax, Bombay City I, reported in 35 ITR 134, which was rendered in context of the provisions of section 18(3A) and (3C) of the Indian Income Tax Act, 1922 was cited for the proposition that where the non-resident had indicated only the mode of payment by nominating an agent to whom the amount is to be paid, it was held that it was the responsibility of the assessee to the non-resident and that responsibility remained and therefore, the assessee was under a duty to deduct income tax and super-tax under the said provisions and was responsible for the tax.

[q] The decision of the Supreme Court in Standard Triumph Motor Co. Ltd. v. Commissioner of Income Tax, reported in 201 ITR 391, which was rendered in context of sections 5(2) and 145 of the said Act, was cited to point out that, where there was a collaboration agreement between a non-resident and an Indian Company and the appellant was entitled to a royalty of 5% thereunder, on all sales effected by the Indian company, the royalty less the Indian tax had to be remitted to the appellant in pounds sterling, it was held that the credit entry of the royalty to the account of the appellant in the books of the Indian company amounted to receipt of the royalty by the appellant and it was accordingly taxable. It was held that it was immaterial when the appellant actually received it in the U.K. and the method of accounting adopted by the

appellant was irrelevant, and, therefore, the order of remand made by the Tribunal was unnecessary.

[r] The decision of the Hon'ble Supreme Court in Hyderabad Industries Ltd. v. Union of India, reported in 1995 ELT 641 was cited for the proposition that the asbestos fibre that is removed from the parent rock is in every respect the asbestos that was embedded in it. No process of manufacture can be said to have been employed by the appellants, nor was a new or distinct commodity released therefrom, as held by the Supreme Court. It was held that such asbestos fibre was, therefore, not liable to excise duty.

[s] The decision of the Bombay High Court in Commissioner of Sales Tax v. Delhi Iron & Steel Company Pvt. Ltd., reported in 1995 S.T.Cs. 202 was cited to point out that, in a case where the ship was condemned and unserviceable at the time of sale and under the agreement, it was sold for breaking and scraping purposes, the Bombay High Court held that the condemned and unserviceable ship purchased by the dealer was not a ship but a re-rollable scrap in the form of an old ship for dismantling. In effect, the dealer acquired only the old material and articles contained therein which were sold by it in the form in which they were acquired and no process whatsoever was applied to the goods, much less any process of manufacture. It was held that the question of using the goods purchased in the manufacture of other goods, therefore, did not arise and section 13 of the Bombay Sales Tax Act, 1959 was not applicable.

[t] The decision in Collector of Central Excise, Madras v. M/s Kutty Flush Doors & Furnitures Co. (P) Ltd., reported in 1988 (supp) SCC 239 was cited for the proposition that "manufacture" implies a change, but every change is not manufacture, yet every change of an article is result of treatment, labour and manipulation. But something more was necessary and there must be transformation; a new and different article must emerge having a distinct name, character or use. (See para 5 of the judgement).

[u] Decision of the Supreme Court in Lucky Minmat Pvt. Ltd. v. Commissioner of Income Tax,

reported 245 ITR 830 which was rendered in context of the provisions of section 80HH of the said Act, was cited to point out that the Supreme court held therein that the conversion into lime and lime dust or concrete by stone crushers could legitimately be considered to be a manufacturing process while mere mining of lime stone and marble and cutting the same before it was sold in the market could not be so considered.

[v] Decision in Divisional Deputy Commissioner of Sales Tax v. Bherhaghat Mineral Industries, reported in 246 ITR 230, the Supreme Court held that the crushing of dolomite lumps into chips and powder was not a process of manufacture that brings about a new commodity.

IV CONTENTIONS AND CASES CITED FOR THE ASSESSEES:

8. The two learned Senior Counsel and other counsel, who appeared for the assessees in all these appeals, contended that the assessees had not made any payment to the non-residents from whom the ships were purchased, because, in view of the independent contract between the assessees and their bankers for taking out irrevocable letters of credit, the assessees had made payment of the amounts to the bank in India and not to the non-residents. They were, therefore, not liable to deduct tax at source under section 195(1) of the Act. It was then argued that the amount in question though described as interest in the MOA was not "interest" within the meaning of section 2(28A) of the said Act, or within the meaning of the definition of "interest" in the Article concerning taxation of interest in the Double Taxation Avoidance Agreements. It was argued that the amount though described as interest was, in fact, part of the purchase price of the ship, because, it was payable with the purchase price at the end of the usance period of 180 days. It was submitted that the accounting entries reflecting that the amount was paid by way of interest were irrelevant for deciding the taxability of the item and that mere nomenclature attributed to the amount was not decisive. It was then contended that in view of the provisions of the DTAAs, the amount in dispute was not chargeable to tax in India because it was not interest within the meaning of definition of interest under the D.T.A.A. It was therefore part of the business profit which was required to be taxed abroad and not in India under the Article concerning taxation of business profits contained in the Agreement. It was submitted

that the amount of purchase price was not a debt because what was paid to the seller was one price at the end of the usance period which was an incremental or deferred price. According to the counsel, reading the provisions of the Income Tax Act and the DTAA, the amount received by the seller could only be profit arising out of business and taxable abroad. It was also contended that the obligation of the buyer was discharged on the date when the L.C. was released and the obligation was taken over by the Indian bank as the principal obligor which was to be honoured by the bank at the end of the usance period of 180 days. It was submitted that if the issuing bank failed, the seller could have no remedy against the buyer. It was argued that unpaid purchase price is not a debt and payment for unpaid purchase price was not a claim for a debt, but it remained to be a claim for unpaid purchase price. It was also submitted that the DTAA for Indonesia in 1989 and Philippines in 1980 which are reproduced in 177 ITR (Statutes) and 299 ITR (Statutes) respectively included in the definition of interest, the words "including interest on deferred payment sales" after the words "debt claims" which shows that in other Agreements where these words were not put into parenthesis, the idea was not to include interest on deferred payment sales within the meaning of the expression debt claims. It was submitted that the buyer had no option to pay the amount of purchase price earlier and that by itself showed that the interest amount payable alongwith the price at the end of the usance period of 180 days was a part and parcel of the price of the ship bought by the assessees. It was also argued that the customs authority would levy the duty on the value of the goods of import as may have been disclosed and the fact that the customs duty was charged on the purchase price of the ship and not on the interest amount considering the later to be part of the price would not be conclusive for holding that the interest amount was not a part of the purchase price. The learned counsel have also contended that shipbreaking was an activity for manufacture of production of new articles or things because the raw material that was ship was converted into totally different articles mainly steel plates.

8.1 In support of their contentions, the learned counsel for the assessees relied upon the following decisions :

[a] The decision of the Supreme court in Federal Bank Ltd. v. V.M.Jog Engineering Ltd. and another, reported in (2001) 1 SCC 663 was cited for the

proposition that the contract of the bank guarantee or the letter of credit is independent of the main contract between the seller and the buyer. This is also clear from Articles 3 and 4 of the Uniform Commercial Practice of Documentary Credits (1983). In case of an irrevocable bank guarantee or letter of credit, the buyer cannot obtain injunction against the banker on the ground that there was a breach of the contract by the seller. On the basis of this decision, it was argued that since as per the Uniform Commercial Practice, the negotiating bank pays the seller when satisfied that the documents appear on their face to be in accordance with the terms and conditions of the credit and the issuing bank is bound to reimburse the negotiating bank, it cannot be said that the issuing bank is making payment to the seller, who was the non-resident.

[b] The decision of the Supreme Court in United Commercial Bank v. Bank of India, reported in AIR 1981 SC 1426 was cited for the proposition that the credit contract is independent of the sales contract on which it is based, unless the sales contract is in some measure incorporated. Unless documents tendered under a credit are in accordance with those for which the credit calls and which are embodied in the terms of the paying or negotiating bank, the beneficiary cannot claim against the paying bank and it is the paying bank's duty to refuse payment. The Supreme Court held that the rule was well established that a bank issuing or confirming a letter of credit is not concerned with the underlying contract between the buyer and the seller. The duties of a bank under a letter of credit are created by he document itself, but in any case, it has the power and is subject to the limitations which are given or imposed by it, in the absence of the appropriate provisions in the letter of credit. (paragraph 38).

[c] The decision of the Supreme Court in M/s Tarapore and Co., Madras v. Tractoroexport Moscow and another, reported in AIR 1970 SC 891 was referred to for the same proposition that the letter of credit is independent of and unqualified by the contract of sale or underlying transaction. The Court held that the autonomy of an irrevocable letter of credit is entitled to protection. As a

rule, the Courts refrain from interfering with that autonomy.

[d] The decision in A.D.Sasoon & Co. Ltd. v. C.I.T. Bombay City, reported in XXXVI ITR 27 was cited for the proposition that a debt must have come into existence and a right must have been acquired to receive the payment. It was held that unless and until assessee's contribution or parenthood is effective in bringing into existence a debt or a right to receive the payment or in other words a debitum in praesenti, solvendum in futuro, it cannot be said that any income has accrued to him. The Supreme Court held that income may accrue to an assessee without the actual receipt of the same. If the assessee acquires a right to receive the income, the income can be said to have accrued to him, though it may be received later on its being ascertained. The basic conception is that he must have acquired a right to receive the income. There must be a debt owed to him by somebody. Unless and until there is created in favour of the assessee a debt due by somebody, it cannot be said that he has acquired a right to receive the income or that income has accrued to him. The matter related to managing agency commission which was at an annual payment calculated upon the annual net profit of the company, and was to be due to the managing agents yearly on the 31st March in each and every year. In that context, the Supreme Court held that the amount of such commission did not become a debt owing by the company to the managing agents until the 31st March in each and every year and was to be paid immediately after the annual accounts of the company have been passed by the shareholders. It was held that the managing agency agreement was an entire and indivisible contract stipulating a payment of remuneration or commission per year and enjoined upon the managing agents the duty and obligation of rendering the services through the company for the whole year by way of condition precedent through their earning any remuneration or commission for the particular accounting year.

[e] The decision of the Supreme Court in Tuticorin Alkali Chemicals v. C.I.T. reported in 227 ITR 172 which was referred lays down that income tax is attracted at the point when the income is

earned. The Court held that the application or destination of income has nothing to do with its accrual or taxability, and that it was also well settled that interest income is always of revenue nature unless it is received by way of damages or compensation.

[f] The decision of the SC in Dr. Shamlal Narula v. C.I.T. reported in 53 ITR 151 was cited to point out that, in context of the provisions of section 34 of the Land Acquisition Act, 1894, the Supreme Court held that the statutory interest paid under the said provision on the amount of compensation awarded for the period from the date the Collector has taken possession of land compulsorily acquired, is interest paid for the delayed payment of the compensation and is therefore a revenue receipt liable to tax under the Income Tax Act. The Supreme Court observed that interest pertains to the domain of payment after the compensation has been ascertained. It is a consideration paid either for the use of money or for forbearance from demanding it after it has fallen due. The Court held that the Land Acquisition Act itself makes a clear distinction between the compensation payable for the land acquired and the interest payable on the compensation awarded. The Court approvingly cited the observations of Lord Wright in Westminster Bank Ltd. v. Riches (1947) (28) Tax Cases 159 at 189] which indicate that interest, whether it is statutory or contractual, represents the profit the creditor might have made if he had the use of the money or the loss is suffered because he had not that used. The SC held that it is something in addition to the capital amount, though it arises out of it.

[g] In TNK Govindraju Chetty v. CIT Madras, reported in 66 ITR 465, the Supreme Court held that the principle in Shamlal Narula's case [supra] that if the source of the obligation imposed by the statute to pay interest arises, because, the claimant is kept out of his money, the interest received is chargeable to tax as income, will apply if interest is payable, under the terms of an agreement, expressed or implied and the court or the arbitrator gives effect to the terms of the agrement and awards interest which has been agreed to be paid.

[h] The decision of the Supreme Court in Kedarnath Jute Mfg. Co. Ltd. v. C.I.T., Calcutta, reported in 82 ITR 363 was cited for the proposition that, whether the assessee is entitled to a particular reduction or not will depend on the provisions of law relating thereto and not on the view which the assessee might take of his rights; nor can the existence or absence of entries in his books of account be decisive or conclusive in the matter.

[i] In the decision of the Court of Appeal, in Re Charg Card Services Ltd. reported in (1988) 3 All E.R. 702, which was rendered in context of payments in respect of sale of goods by credit card transaction, it was held that there was no general principle of law that, whenever a method of payment was adopted which involved a risk of non-payment by a third party, there was a presumption that the acceptance of payment through the third party was conditional on the third party making the payment, and that, if he fails to pay, the original obligation of the purchaser remained. Each method of payment had to be considered in the light of the consequences and other circumstances attending that type of payment.

[j] The decision of the Supreme Court in Ferro Alloys Corporation Ltd. v. A.P. State Electricity Board, reported in AIR 1993 SC 2005, where the Supreme court was concerned with the question of payment of interest on security deposit by high tension consumers of electricity shows that, in that context, it was held by the SC that the word "interest" would apply only to cases where there is a relationship of a debtor and creditor. A lender of money who allows the borrower deprives himself of the use of those funds. He does so because he charges interest which may be described as kind of rent for the use of the fund. It was held that, in the case before it, there was no relationship of debtor and creditor. The SC held that the deposit made cannot be equated to a fixed deposit because in the case of Delhi Supply of Electricity, there was a consequential liability on the consumer to pay for each day's consumption of electricity and to ensure that payment, the security deposit was furnished.

[k] The decision of the Supreme Court, in Radha

Kissen Chamria and others v. Keshardeo Chamria and another, reported in AIR 1957 SC 743, which was rendered in context of the provisions of section 30 of the Bengol Money Lenders Act, 1940, was cited to point out that the SC held that the purchasers could not claim any benefit under Section 30 inasmuch as they were neither borrowers nor were they being made to pay in respect of a "loan" as those terms were defined in the Act; the fact that under the compromise decree, the moneys were payable in a number of installments instead of at once would not show that the price had become a loan, nor was there anything to show that the parties had treated the purchase money as paid off in its entirety and the amount equivalent to the purchase money as being due by the purchasers to the vendor by way of a loan on which basis the transaction might in substance be a loan. Section 2(12) of that Act defined loan so as to mean an advance, whether of money or any kind, made on condition of re-payment with interest and included any transaction which was in substance a loan. The SC observed that the case before it admittedly was not a case of an advance in kind, nor was it a case in which there was an actual advance of money.

[l] The decision in Vijay Bank Ltd. v. Commissioner of Income Tax, reported in 187 ITR 541 was cited to point out that, in a case where the assessee purchased securities at a price determined with reference to their actual value as well as the interest accrued thereon till the date of purchase, the entire price paid for them would be in the nature of a capital outlay and no part of it can be set off as an expenditure against the income by way of interest received on the securities. It was contended before the SC that the price paid for the securities was determined with reference to their actual value as well as the interest which had accrued on them till the date of purchase. But the fact was, whatever was the consideration which prompted the assessee to purchase the securities, the price paid for them was in the nature of a capital outlay and no part of it could be set off as expenditure against the income accruing on those securities. It was held that subsequently when the securities yielded income by way of interest, such income attracted section 18 of the said Act. The Court held that

a claim for deduction can be sustained only when the assessee is in a position to show that any reasonable expenditure had been incurred for the purpose of realizing with interest on securities.

[m] The decision of the Lahore High Court in Haveli Shah Sardarilal v. Commissioner of Income Tax, Punjab, reported in 4 ITR 297 was cited for the proposition that the mere quotation in the bargain, of estimated accrued interest, does not establish a separate contract, in respect of the interest. Even if it were considered to be a separate contract, it would remain part and parcel of the whole purchase consideration and would not be deductible. In that case, the assessee had purchased securities at a price expressed as a capital sum plus interest computed de die in diem from the last due date to the date of sale, and the question was whether the said computed interest was deductible from the interest actually received by the assessee, in assessment under Section 8 of the Indian Income-Tax Act, 1922.

[n] The decision of the Court of Session (Scotland), First Division, in the Commissioners of Inland Revenue v. Ballantine, reported in VIII Tax Cases 595, was cited for the proposition that, where the award was substantially one of damages, the sum added in the name of interest was merely part of the damages, and was not "interest of money" chargeable to Income Tax under Case III of Schedule - D to the Income Tax Act, 1918. It was held that the interest awarded in that case truly constituted that part of the compensation discerned for which it is attributable to the fact that the claimant had been kept out of his due for a long period of time. The Court held that the form of award in the case before it seemed to make it impossible to distinguish the character of the so-called interest between the 4th of November 1981 and the date of the award, from its character between the date of the award and the date of payment.

[o] The judgement of the High Court of Justice [King's Bench Division] in Wigmore v. Thomas Sommerson & Sons. Ltd., reported in 9 Tax Cases 577 was a case where a company sold a holding of 5% war-stock on the 10th April 1923. The sale was with interest rights, such stock not being

dealt in "ex-interest" until the 1st May 1923. An assessment to income tax was made upon the vending company for the year 1923-24 in respect of the amount of interest deemed to have accrued on the stock in the period between the last payment of interest and the sale of the stock, it being contended that the price received by the company on sale of the stock included this interest. The Court found that the stock was sold for a sum for principal and accrued and accruing interest; and it was not true to say in fact that in the purchase price there was necessarily to be found a sum as purchase money of the accrued interest exactly equivalent to the amount of interest which had accrued. It was therefore held that the company was not assessable in respect of the interest accrued at the date of the sale of the stock and the appeal was dismissed.

[p] In the decision of the High Court of Justice [King's Bench Division] reported in XIV Tax Cases 580, the question involved was whether compensation under Prize Chitty computed on the basis of interest was income. It was held that the income in question arose when received by the banks and that the compensation was not income for income tax purposes. Lord Hanworth M.R. held that the way to estimate compensation or damages - sensible way no doubt would be by calculating a sum in terms of what interest it would have earned. That had been done but the sum that was paid had not been turned into interest so as to attach income tax to it. It remained compensation and for these reasons, it was not a sum which attracted or attached income tax to it. It was held that the judgement of Mr. Justice Rowlatt was right and the appeal must be dismissed. Justice Rowlatt had held that sum first came into existence by the Award and no previous history or anterior character can be attributed to it.

[q] In Commissioners of Inland Revenue v. Pilcher, a decision of the Court of Appeals, reported in 31 Tax Cases 314, was a case in which a fruit-grower and fruit-salesman purchased for 5500 Pounds the free-hold of a cherry orchard inclusive of the year's fruit crop, which was nearly ripe for picking. Before the sale, he had valued the growing crop at 2500 pounds, and subsequently it

was picked and sold for 2903 Pounds, which sum was brought into accounts as a trading receipt. On appeal against assessment to income tax under Schedule-D and to excess profit taxes, it was contended that sum of 2500 Pounds should be charged in the accounts as the purchase price of the cherries sold either on the ground that the cherries did not form part of the fructus industriales and not fructus naturales or on the ground that it should be so charged on proper commercial principles. The Crown contended that the cherries formed part of the land and the purchase was a single operation resulting in the acquisition of a single capital asset. The Special Commissioner held that a deduction representing the costs of the cherries was permissible. The Court held that no part of the purchase price of the land could be deducted for arriving at the profit from the sale of the crop.

[r] The decision of the Andhra Pradesh High Court in the Commissioner of Income Tax, Andhra Pradesh v. Vishakhapatanam Port Trust, reported in 144 ITR 146 on which the reliance was placed by the Tribunal was referred to for the proposition that, under Article VIII of the Double Taxation Avoidance Agreement between the Federal Republic of Germany and India, interest would be assessable in India if it arises out of "indebtedness", and that an agreement to pay the balance of consideration due by the purchaser does not give rise to a loan. The Court held that when the payment of interest is part and parcel of the agreement to pay the unpaid purchase money on a deferred payment basis, there is no indebtedness. If there is no agreement initially or by way of novation to treat balance of sale consideration as paid off in full and no novation to treat the balance of consideration as a loan, the amount received by the seller cannot be regarded as interest on money lent. It was a matter where a German company tendered contract for the supply of the equipment and an agreement was entered into between the German company and the Port Trust whereby the German Company undertook to supply the equipment and to delegate an engineer to supervise its installation under Clause 10(a) of the contract. The purchase price for the equipment was payable in German currency in Germany. Part of it was payable on conclusion

of the contract and the balance was payable in 20 semi annual installments. For the credit remaining after payment of each of the installments, interest was to be paid by the port trust at 6% per annum. The port trust paid the installments in Germany currency in Germany. The I.T.O. held that the port trust should have deducted tax at source on the interest u/s 195(2) of the Act. When the matter reached the Tribunal, the assessee for the first time raised the question whether the tax was deductible in view of the Indo-German Double Taxation Avoidance agreement, the Tribunal considered the applicability of the agreement and found that the actual installation work was not done by the German company and the German company had no permanent establishment in India within the meaning of the agreement and interest did not arise out of "indebtedness" within the meaning of the agreement. On reference, the High Court held, as noted above, that interest would be taxable if it arose out of indebtedness. The Court noted that the expression "debt" may take colour from the provision of the concerned Act. It also noted that when interest is paid not as part of compensation but is given for the depreciation of the use of the money, it is an independent source of income and is taxable, referring to the decision of the apex Court in Dr. Shamlal Narulal's case (supra). It also held that if the right to interest arises because the person is kept out of his money, the interest received is chargeable to tax as income and that the same principle would apply if interest is payable under the terms of an agreement and the court or arbitrator gives effect to the terms of the agreement and awards interest and in this regard, it referred to the decision of the Apex Court in TNK Govindraj Chetty (supra). It, however, held where the interest is merely in name but constitutes part of the compensation or part of the damages, it is not "interest" chargeable to income tax. As an integral part of such compensation, it may be either slumped up with the other elements in the gross sum or may be separately stated but treated as a part of the gross sum. On this, the Court referred to Valentine (supra). It then proceeded to observe that mere description of the amount as interest which in fact is part of the compensation does not have the effect of altering the true

character of the compensation and for this, it referred to Samsung (supra). After referring the ratio of various decisions approvingly, the Court observed that the same was the position with regard to unpaid purchase money coupled with a liability to pay interest alongwith each of the installments. It was held that where as was the case before it , parties entered into an agreement to accept a portion of the purchase money immediately and the balance to be paid in certain installments alongwith interest on the installment of purchase money, the agreement though it vested the property agreed to be sold in the purchaser, does not have the effect of converting the price due into a loan. The intrinsic nature of the money due to the vendor is as unpaid purchase money and not as debt. It was observed that the parties may however agree to convert the unpaid purchase money as a debt, referring to Radha Kissen v. Keshavdeo (supra).

[s] The decision of this Court in Commissioner of Income Tax, Gujarat v. Saurashtra Cement & Chemical Industries Ltd., reported 101 ITR 502 was cited to point out that the Court, in context of the provisions of section 9(1)(i) of the Income Tax Act, held that since most of the elements of the contract were found to be densely grouped with the other country which was Italy where the non-resident company was carrying on its business of supplying plant and machinery and the debt which the assessee company owned to the non-resident company was not an asset held by the non-resident company in India, the interest which was payable in respect of the debt was not income arising from or through any asset held by the non-resident company in India. As regards the alternative argument made on behalf of the Revenue that income accruing or arising through from any money lent on interest and brought into India, in cash or in kind, was taxable in India, it was held that, in view of the decision of the Supreme Court in Bombay Steel Navigation Company v. C.I.T. reported in 56 ITR 52, obviously the amount of unpaid price could never have been said to be a loan advanced by the non-resident company to the assessee company. It was held that since the non-resident company could not be said to have lent the amount of the unpaid purchase price to the assessee company either in cash or in kind, there was no question of the interest

payable by the assessee company to the non-resident company being deemed to be income accruing or arising from any money lent at interest and brought into India in kind. The Court, therefore, held that the amount payable by the assessee to the company by way of interest on the unpaid purchase price so far as the amount represented by the bills of exchange was concerned, was not taxable in the hands of the assessee as agent of the non-resident company under Section 9(1)(i) of the Act. It will be seen that this decision was rendered on 23rd September 1974, much prior to the insertion of the provisions of clause (v) in section 9(1) of the Act by the Finance Act, 1976 w.e.f. 1-6-1976.]

[t] Decision of the Supreme Court in Central Bank of India v. Ravindra and others, reported in AIR 2001 SC 3095 was cited to point out that, in paragraph 37 of the judgement, the Supreme Court referred to the definition of "interest" in Black's Law Dictionary (7th Edition), in which it was defined, inter alia, as the compensation fixed by agreement or allowed by law for the use or detention of money, or for the loss of money by one who is entitled to its use; especially, the amount owed to a lender in return for the use of the borrowed money. The meaning of word "interest" from Stroud's Judicial Dictionary of Words and Phrases (5th Edition) was also referred and it was defined therein to mean, inter alia, compensation paid by the borrower to the lender for deprivation of the use of his money. The opinion of Lord Wright, in Riches v. Westminster Bank, Ltd. was also referred, as per which, the essence of interest was that it is a payment which becomes due because the creditor has not had his money at the due date. It may be recorded either as representing the profit he might have made if he had the use of the money, or, conversely, the loss he suffered because he had not that use. The Court observed that the general idea is that he is entitled to compensation for the deprivation; the money due to creditor, was not paid, or, in other words, was withheld from him by the debtor after the time when payment should have been made, in breach of his legal rights, and interest was a compensation whether the compensation was liquidated under an agreement or statute.

[u] The decision of the High Court in Commissioner of Income Tax, West Bengal IV v. Smt. Asrafi Devi Rajgharia, reported in 142 ITR 380 was cited to point out that the Court accepted the contention on behalf of the assessee that none was entitled to payment of interest unless the amount on which the interest was claimed was quantified and was payable to him (page 399 of the Report).

[v] In the decision of the Supreme Court in K.S.Krishna Rao v. Commissioner of Income Tax, Andhra Pradesh, reported in 181 ITR 408 which was rendered in context of the provisions of section 28 of the Land Acquisition Act, in which the Court followed its earlier decision in Rama Bai v. CIT [1990] 181 ITR 400, it was held that the interest on enhanced compensation for land compulsorily acquired under that Act awarded by the Court on a reference under Section 18 or on further appeals, had to be taken to have accrued not on the date of the order of the court granting enhanced compensation but as having accrued year after year from the date of delivery of possession of the land till the date of such order, and such interest cannot be assessed to income tax in one lumpsum in the year in which the order was made, and that interest paid on compensation awarded was of the nature of income and not capital.

[w] The decision of the Supreme Court in Keshav Mills Ltd. v. Commissioner of Income Tax (Bom.), reported in 23 ITR 230 was cited for the proposition that merely because the goods have been supplied and the price thereof has been debited to the purchaser, the rights and obligations of the vendor as purchaser inter se are not in any manner affected. The Supreme Court held that the vendor is bound to fulfill all his obligations under the contract and continues to be liable for all the consequences of his default including rejection of his goods by the purchaser or a claim for damages for breach of warrantee by him. It was held that the purchaser is equally entitled to reject the goods or to claim the damages as on breach of warrantee by the vendor and all these rights and obligations have got to be worked out inspite of the fact that the entries are made in the books of account by the vendor in accordance with the

mercantile system of accounting adopted by him. The vendor could not say that he is under no further obligation to the purchaser and that the purchaser must pay the price of goods debited to him as a debit arising out of the book entry. It was held that the count in any action filed by the vendor against the purchaser would be a count for the price of goods sold and delivered and would not be a count on an assumpsit or for recovery of a debt due by the debtor to him. In the same judgement, the Supreme Court referring to the nature of the mercantile system of accounting, has held that the mercantile system brings into credit what is due, immediately becomes legally due and before it is actually received and it brings into debit expenditure the amount for which a legal liability has been incurred before it is actually disbursed. The profits or gains of the business which are thus credited are not realised but having been accrued are treated as received though in fact there is nothing more than an accrual or arising of the profits at that stage. They are book profits. Receipt being not the sole test of chargeability and profits and gains that have accrued or arisen or are deemed to have accrued or arisen are also liable to be charged for income tax, the assessibility of these profits which are thus credited in the books of account arises not because they are received but because they have accrued or arisen.

[x] The decision of this Court in Meteor Satellite Ltd. v. I.T.O., Companies Circle IX, Ahmedabad, reported in 121 ITR 311 was cited to point out that, while rejecting the preliminary objection against the maintainability of the petition in view of the alternative remedies available to the petitioner under the Act, the Court held that in order to facilitate the remittance of the amount of the first two installments payable to the collaborator in sterling, the petitioner was entitled, if it were right in law, to have a tax clearance certificate from the I.T.O. It could not, in view of the terms of the agreement, wait for the long process of having the matter assessed and then tested by way of an appeal etc. under the provisions of the Income Tax Act, 1961. It was held that, under the circumstances, the existing machinery by way of regular assessment was totally inadequate and unsuitable for the

problems that were faced by the petitioner. It was held that, in order to enable the petitioner to get the approval of the Reserve Bank of India, it was obligatory on the respondent to issue a certificate to that effect. The Court ordered certificate to be issued within four weeks. It will be noted that, in the present case, the assessee did not make any such application for obtaining any certificate from the assessing officer on the ground that no deduction of tax at source was required to be made by them in respect of the payments made to the sellers.

[y] The decision of the Bombay High Court in Porbandar State Bank v. Commissioner of Income Tax, Bombay city, reported in 18 ITR 134 was a case where the assessee Porbandar State Bank as ordinary resident in British India was assessed to income tax under the provisions of the Government Trading Taxation Act, 1926. It had received deposits in Porbandar State and claimed that interest paid to the depositors on such deposits was an allowable deduction under Section 10(2)(iii) of the Indian Income Tax Act, 1922. The assessee did not deduct tax at source under Section 18(3)(a) of the Act of 1922. Income Tax authorities disallowed the deduction under the proviso to section 10(2)(iii) of that Act on the ground that as the interest was chargeable under Section 42 and was paid outside British India, the assessee could have deducted tax at source under Section 18(3)(a). The court held that, in order to deprive the assessee of the deduction under section 10(2)(iii), it must be found that the persons who deposited moneys with the assessee and earned interest on the deposits knew as a part of the integral transaction of the deposit that the assessee would take this money to British India and utilize it for the purpose of earning income on it. It was held that since it was not established that there was any knowledge on the part of the lender that his deposit would be transferred to British India for the purposes of earning income on it, the interest earned by the depositors was not chargeable under the Indian Income Tax Act and there was no obligation upon the assessee to deduct tax under Section 18(3)A. The assessee was therefore entitled to the deduction under Section 10(2)(iii) of the Act.

[z] In Commissioner of Income Tax, Bombay City I v. Cooper Engineering Ltd., reported 68 ITR 457, the Court, in context of the provisions of section 4(1) and 18(3B) of the Indian Income Tax Act, 1922, held that unless any payment of interest is such that the interest is chargeable under the Act, the liability upon the person responsible for paying such interest to deduct the tax at source is not there. The Court found upon the facts that the amount of interest payable to M/s Tata Ltd., London, was not an amount chargeable under the Act. It was therefore held that there was no obligation upon the assessee to deduct the amount of interest at source. The Court held that the words "chargeable under the provisions of this Act" in section 18(3B) apply to "interest" as well as "any other sum" and consequentially a person paying interest to a non-resident is not liable to deduct tax on the said interest if it is payable to the non-resident in respect of the money payable to him for service rendered without the taxable territories, which, u/s 4(1) of the Act of 1922, was not chargeable to tax under the Act.

[z-1] The decision of Kerala High Court in United Construction Contractors v. C.I.T., reported in 208 ITR 914 was a case where the assessee was a contractor under the Public Works Department. The dispute regarding payment for his bills was referred to arbitration and under the award, he was entitled for an amount for the work done for which the bills were pending and also an amount by way of interest, as also future interest. The assessee contended that the interest payable by the Public Works Department was neither under a statute nor under a contract and so it was only on an exgratia basis, and could not be taken as a revenue receipt. This contention was rejected by the revenue authorities and the Tribunal. The High Court held that the interest paid to the assessee partook of the same character and the receipts, the payment of which he was otherwise entitled to under the contract and which payment was delayed as a result of certain disputes. It was held that the interest amount of the revenue receipts liable to be taxed for the Assessment Year 1979-80. It was a finding recorded by the Tribunal that the assessee was following the cash system of accounting.

[z-2] In the decision of the Supreme Court in Commissioner of Income Tax, A.P. v. Toshoku Ltd. reported in 125 ITR 525, dealing with the question where the commission earned by a non-resident sales agent could be taxed in India treating "B" to whom the sale price received on the sale in Japan was remitted wholly in India and who debited his commission account and credited the amount of commission payable to the Japanese company in his account book and later remitted the amount to the Japanese company, it was held that it could not be said that the making of entries in the books of "B" amounted to receipt, actual or constructive, by the non-resident sales agents as the amounts was credited in their favour were not at their disposal or control; they could not therefore be charged to tax on the basis of the receipt of income, actual or constructive, for the taxable territories. It was held that a credit balance, without more, only represents the debt and a mere book entry in the debtor's own books does not constitute payment which will secure a discharge from the debt.

[z-3] The decision of the Calcutta High Court in C.I.T. v. Davy Ashmore India Ltd. reported in 190 ITR 626 which was rendered in context of the provisions of sections 9 and 90 of the Act and the Double Taxation Avoidance between Indian and U.K. was cited for the proposition that in case of inconsistency between the terms of the Double Taxation Avoidance Agreement and the taxation statute, the Agreement alone would prevail.

[z-4] The decision of the Calcutta High Court in Cosi, Agent Stock Company v. I.T.O. reported in 81 ITR 162, while considering the provisions of section 195(2) of the said Act, held that the said provision pre-supposes that the person responsible for making the payment to the non-resident is in no doubt that tax is payable in respect of some part of the amount to be remitted to a non-resident, but is not sure what should be the portion so taxable or the amount of tax to be deducted. He can then make an application to the I.T.O. for determining the amount. It was held that it is only when these conditions were satisfied and an application is made to the Income Tax Officer that the question of making an order under Section 195(2) will

arise. Where the I.T.O. is only approached for a certificate that no tax was due in respect of freight charges for goods unloaded at an India Port as such a certificate was required by the Reserve Bank, it cannot be said that an application has been made under Section 195(2) of the Act and any order under Section 195(2) in such case would be in excess of the jurisdiction conferred by the Act.

[z-5] The decision of the Allahabad High Court in CIT v. Meerut Biri Factory reported in [1998] 146 CTR (Allahabad) 489 was cited for the proposition that when interest is credited in the books of the assessee in India, it is not payable outside India within the meaning of Section 49 (a)(I) and hence, not disallowable under that Section.

[z-6] The decision of the Hyderabad High Court in CIT, Hyderabad v. Nagaria Oil Mills, reported in 25 ITR 258 was cited to point out that in context of the provisions of Section 24 (4) of the Hyderabad Income Tax Act which corresponded to Section 18(3A) of the Indian Income Tax Act, 1922, it was held that it was open to the Income Tax authorities not to allow the deduction when they found that interest was in fact deducted or no interest was paid to the non-resident entitled to receive the amounts. It was held that the word "payment" in Section 24 (12) of the Hyderabad Act should be interpreted as meaning "actual payment" and, therefore, crediting of interest amounts to the accounts of the lenders could not be deemed to be payment within the meaning of that sub-section so as to attract Income Tax at the maximum rate under Section 24(12) of the Act.

[z-7] The judgement of the Bombay High Court in Ship Scraps traders c. CIT (BOM) reported in 251 ITR 806 was cited to show that the question whether the ship breaking activities in which the assessees were engaged amounted to manufacture or production activities for the purposes of deductions under Sections 80 HHA and 80-I of the Act was decided in favour of the assessees holding that they were entitled to claim deductions under these provisions. Relying upon the earlier decision of the Court in C.S.T. v. Indian Metal Traders, reported in (1978) 41 STC 169 in which it was held that scrap iron and

steel which were obtained by the respondents by dismantling and breaking up of the ship must be regarded as a different commercial commodity from their ship itself, and hence, the activity would amount to manufacture, the Court held that considering the peculiar nature of ship breaking activity, it gives rise to manufacture and production of altogether new commercial articles or things which were commercially identifiable in the commercial world as other than the ship and therefore, the assessees should be entitled to claim deductions under the said provisions. The Court held that the input of the ship breaking industry, namely ship, covered by Chapter 89, is used to manufacture its output, namely metal scrap covered by Chapter 72 to 81 of the Customs and Central excise Tariff Act. It was held that in the course of breaking activity, the ship loses its identity and results into production of the items ferrous metals and non-ferrous metals as well as non-metalic material enumerated in the judgement.

[z-8] Decision in Commissioner of Income Tax v. Ashwinkumar Gordhanbhai and Bros. Pvt. Ltd., reported in 212 ITR 614 which was rendered in context of section 104(4) of the Act, was cited for the proposition that the activities of the assessee in cutting the tobacco leaves into small leaves or pieces and after removing the dust and unwarranted stems of the tobacco leaves, selling them to the bidi manufacturers, involved "processing" of goods.

[z-9] Decision of the Supreme Court in Ujagar Prints v. Union of India, reported in 179 ITR 317 was cited for the proposition that the processes of bleaching, dyeing, printing, sizing, shrink-proofing, water-proofing, rubberising and organdie processing carried on in respect of cotton or man-made grey fabric amount to "manufacture" for the purpose and within the meaning of section 2(f) of the Central excises and Salt Act, 1944.

[z-10] Decision of the Madras High Court in Commissioner of Income Tax, Madras v. M.R.Gopal, reported in 58 ITR 598 which was rendered in context of section 15(c) of the Indian Income Tax Act, 1922, was cited for the proposition that the process employed in converting boulders into small stones

with the aid of machinery is a manufacturing process and the undertaking is an "industrial undertaking" and as such entitled to the exemption under Section 15C. The Court referred to the definition of "manufacture" from Webster's Dictionary, where it is defined to mean; "Anything made from raw materials by the hand, by machinery, or by art, as clothes, iron utensils, shoes, machinery, etc.; a manual occupation or trade; to produce by labour especially now, according to an organised plan and with division of labour and usually with machinery."

[z-11] Decision of the Gauhati High Court in Commissioner of Income Tax v. R.C.Construction, reported in 222 ITR 658 was referred in order to point out that it was held that making chips out of big boulders would amount to a manufacturing process and, therefore, the assessee was entitled to investment allowance as envisaged under Section 32A of the Income Tax Act, 1961.

[z-12] Decision of the Madras High Court in Commissioner of Income Tax, Madras v. Perfect Liners, reported in 142 ITR 653, which was rendered in context of the provisions of section 33 of the Act, was cited to point out that it was held therein that the word "manufacture" was used in a wide sense. After the rough casting was polished, the product was a new product which was utilised as a component in internal combustion engines. It was held that the Tribunal having found that the component parts were essential parts for internal combustion engines, the grant of higher development rebate was justified.

[z-13] The decision of the Supreme Court in C.I.T. v. N.C.Budharaja and Company, reported in 204 ITR 412 was cited for the proposition that the word "production" has a wider connotation than the word "manufacture". While every manufacture can be characterized as production, every production need not amount to manufacture. It was held that the word "production" or "produce", when used in juxtaposition with the word "manufacture" takes in bringing into existence new goods by a process which may or may not amount to manufacture. It also takes in all the by-products, intermediate products and residual products which emerge in the course of manufacture of goods. The Supreme Court held that the principle of adopting a

liberal interpretation which advances the purpose and object of beneficial provisions cannot be carried to the extent of doing violence to the plain and simple language used in the enactment.

[z-14] Decision of the Bombay High Court in C.I.T. v. Sterling Foods (Goa) reported in 213 ITR 851 was referred for pointing out that the Court held that the word "production" has a wider connotation than the word "manufacture". The Court followed the decision of the Supreme Court in Budharaja (supra) and observed that three expressions "production", "manufacture" and "produce" used in various taxing statutes are not interchangeable expressions. It will be seen that the Court held on merits that by subjecting of prawns to processing for the purpose of export, they do not lose their original character and no new commodity or article emerges as a result of such processing. That being the position, the provision of section 80HH of the I.T. Act would not apply to the undertaking of the assessee which was engaged in the processing of prawns for making them fit for the market. This decision came to be approved by the Supreme Court in C.I.T. v. Relish Foods, reported in 237 ITR 59 in which it was held that when raw shrimps and prawns are subjected to the provisions of cutting of heads and tails, piling, divining, cleaning and freezing, they do not cease to be shrimps and prawns and do not become other distinct commodities. It was therefore held that the assessee was not entitled to the special deduction under Section 80HH for the A.Y. 1977-78.

[z-15] A series of judgments in context of the provisions like Section 2 (17) of the Bombay Sales Tax Act, 1959 which defined "manufacture" were cited. In Mohammedali Ismail v. Commissioner of Sales Tax (Bombay), reported in 82 STC 50, it was held that the definition of manufacture as contained in Section 2(17) of the Bombay Sales Tax Act, 1959 was wide. The Court held that the process of converting raw hides and skin into tanned or traced hides and skins will, thus, be covered by the word "manufacture".

[z-16] Rajasthan High Court in CTO v. Bhonri Lal Jain, reported in 94 STC 118 held that the blocks and stones had different commercial names in common

and commercial parlance and the dealer was a manufacturer entitled to avail of the benefit of the notification.

[z-17] In Deputy Commissioner of Sales Tax v. Mohammedali, reported in 90 STC 174, the Supreme Court held that the lifeless meat was by any standard of other goods different from goat and sheep for the purpose of purchase tax under Section 5A of the Kerala General Sales Tax Act, 1963. The Court followed its earlier decision in Deputy Commissioner of Sales Tax v. Ismail, reported in (1986) Suppl. Supreme Court Cases, 218.

[z-18] In Ashirvad Ispat Udhyog and others v. State Level Committee and others, 112, Sales Tax Cases, 207, the Supreme Court held in context of the provisions of Section 2 (j) and (12) of the Madhya Pradesh General Sales Tax Act, 1958 that when the appellants treated iron and steel scraps of considerable bulk by cutting it down by mechanical processes into pieces that might be conveniently utilized in rolling mills and foundries, such treatment making saleable goods fell within the wide definition of "manufacture" under Section 2 (j) of the said Act and the appellants were entitled to the relief granted to industrial units under the notification issued under Section 12 of the Act.

[z-19] In Shri Balaji Mineral Grinding Industries v. State of Madhya Pradesh, reported in 117 STC, page 117, the Madhya Pradesh High Court held that making of marble powder by manufacturing process was an activity covered within the special definition of "manufacture" given in Section 2 (j) of the Madhya Pradesh General Sales Tax Act, 1958.

[z-20] In ACTO v. Girrota Silica Udhyog, reported in 93 STC, page 280, the Rajasthan High Court held that in view of the findings of the Tribunal that the mineral was excavated from the mine in the form of lumps, that red or yellow colour on the sides of the lumps was removed and then they were grinded, that the mineral water was thereafter screened and graded etc., the assessees were rightly considered to be manufacturers.

[z-21] In Deputy Commissioner of Sales Tax v. Coco

Fibres, reported in 80 STC 249, where green coconut husk was soaked in saltish water for days together and after decomposition, it was subjected to beating by mechanical or manual process, the coconut fibre produced in the process was a distinct commodity known in commercial parlance. It was held that the respondent, a registered dealer was converting coconut husk into fibre and, therefore, was liable to tax at 4% on the purchase turnover of coconut husk under Section 5A of the Kerala General Sales Tax Act, 1963.

[z-22] In Kumar Rolling Mills Ltd. v. Commissioner of Sales Tax, reported in 87 STD 222, the Madhya Pradesh High Court held that conversion of one category of iron and steel to another was manufacture within the meaning of Section 2 (j) of the Madhya Pradesh General Sales Tax Act, 1958.

V REASONING:

9. The controversy centres around the liability of the assessees to deduct tax at source under Section 195(1) of the said Act on the usance interest as stipulated in the Memorandum of Agreement between the assessee, who was the buyer of the ship, and the non-resident seller, who was the owner of the ship, as mentioned in the contract. The question arose when the assessee deducted the interest amount while computing its income chargeable under the head "profits and gains of business or profession" and on noticing that the interest was paid under the written contract to the non-resident, the assessing officer raised the issue and held under Section 40(a) that such deduction of interest in computing the income under the head "profits and loss of business or profession" was not permissible since the sum was payable outside India and no tax was paid thereon, nor any deduction of tax made at source as required by Chapter XVII-B of the Act. The provision of section 40 of the Act, to the extent relevant, reads as follows :

"Sec.40 Amounts not deductible.

40. Notwithstanding anything to the contrary in sections 30 to 38, the following amounts shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession",--

[a] in the case of any assessee--

[i] any interest (not being interest on a loan issued for public subscription before the 1st day of April, 1938), royalty, fees for technical services or other sum chargeable under this Act, which is payable outside India, on which tax has not been paid or deducted under chapter XVII-B:

Provided that where in respect of any such sum, tax has been paid or deducted under Chapter XVII-B in any subsequent year, such shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid or deducted.

xxx xxx xxx xxx"

Thus, if interest expenditure in respect of which deduction in computing income is claimed is payable outside India, such interest expenditure can be claimed only when the deduction of tax at source is made in respect thereof.

9.1 Section 9 of the Act enumerates the income which shall be deemed to accrue or arise in India. Clause (v)(b) of sub-section (1) of section 9, which came to be inserted with retrospective effect from 1-4-1982 by the Taxation Laws (Amendment) Act, 1984, laid down that the income by way of interest payable by a person who is resident shall be deemed to accrue or arise in India, except where the interest is payable in respect of any debt incurred or moneys borrowed and used, for the purposes of a business or profession carried on by such person outside India. Therefore, in all cases, where the income by way of interest payable by a resident does not relate to carrying on business outside India or earning of income from outside India, such income payable by way of interest would be deemed to accrue or arise in India. In other words, whereever income by way of interest may be payable by the resident, it shall be deemed to accrue or arise in India, that is the source of such income will be from India even if it is payable outside India, and this is the deeming fiction adopted to make such income payable by way of interest by the resident to a non-resident outside India as if it had accrued or arisen

in India. Such interest income which is deemed to accrue or arise to the non-resident in India in a previous year will be a part of the total income of that previous year of such non-resident by virtue of section 5(2)(b) of the said Act. Under sub-section (2) of section 5, not only income received or deemed to be received in India by or on behalf of the non-resident, but also income that accrues or arises or is deemed to accrue or arise to him in India during the previous year is to be included in the total income of the non-resident for such previous year. Explanation 2 to section 5 makes it clear that income which has been included in the total income of a person on the basis that it has accrued or arisen or is deemed to have accrued or arisen to him, shall not again be so included on the basis that it is received or deemed to be received by him in India. Thus, all income from whatever source derived whether actually received or deemed to have been received or whether actually accrued or arisen or deemed to have accrued or arisen to a non-resident in India in a previous year, will be considered to be a part of his "total income" in respect of which income tax shall be charged for that year, as envisaged by section 4(1) of the Act. Section 4(2) specifically provides that, in respect of the income so chargeable under sub-section (1), income tax shall be deducted at source or paid in advance where it is so deductible or payable under the provisions of the said Act.

9.2 The provisions of section 9(1)(v)(b) read with section 5 (2) and section 4(1)(2) leave no room for doubt that the income payable by way of interest by a resident to a non-resident (which is not payable for the purpose of carrying on the business of such resident outside India or for earning income from any source outside India) would be deemed to have accrued or arisen to such non-resident in India, and will be part of his total income that would be chargeable to income tax which shall be deducted at source or paid in advance when it is so deductible at source or payable in advance under the provisions of the Act. If the controversy that the interest payable under the MOA to the non-resident by the assessee is not interest but a part of the price of the ship purchased by the resident is kept apart for the time-being and the amount specified as interest in the MOA is treated as interest payable under the contract by the resident - assessee to the non-resident in respect of deferred payment of price, such interest payable to the non-resident would be income deemed to have accrued or arisen to the non-resident in India under Section 9(1)(v)(b) and would be chargeable to income tax under

Section 4(1) read with section 5(2) of the Act. If that be so, income tax thereon would be deductible at source under Section 195(1) of the Act which, inter alia, provides that any person responsible for paying to such non-resident any interest chargeable under the provisions of the Act (not being the income chargeable under the head "salaries"), shall, at the time of credit of such income to the account of the payee or at the time of payment in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income tax thereon at the rates in force.

9.3 Under the MOA, the assessee was responsible for paying to the seller non-resident, the amounts specified therein for the purchase of the ship for demolition purposes. The assessee was responsible for paying both the amounts of the two separate invoices, one of the purchase price of the ship and the other of the interest amount. The amounts payable under the MOA were payable to the seller of the ship and not to the issuing bank of the assessee that had issued the letter of credit, as per the mode of payment stipulated in the MOA by the seller and the buyer. The liability to deduct the tax at source in such case would be of the assessee by whom the interest was payable and not of the issuing bank that issues the letter of credit. Such liability would arise when credit entry is made on accrual basis in favour of the non-resident in respect of such payable interest even before the actual payment which is yet to follow. The liability of the person responsible for the payment to deduct the tax at source arises when credit entry is made or when payment is made by cash or any other mode of payment, whichever is earlier. The liability of the assessee to deduct the tax from the interest so payable cannot, therefore, depend upon any particular mode that may be adopted by the buyer for making the payment. It would not, therefore, be correct to argue, as has been done, that, the assessee had paid the amount to the issuing bank, which was not a non-resident, and therefore, there was no obligation on the part of the assessee to deduct the tax at source. No such automatic shifting of responsibility in respect of interest payable to the non-resident under the MOA entailing duty to deduct tax at source and thereby shifting the obligation to deduct such tax to the bank which issued the letter of credit as a mode of payment of the amount by the assessee, is contemplated by section 195(1) of the Act. The amount was payable by the assessee as per the M.O.A. and therefore, the liability to deduct the tax was that of the assessee while making payment through the letter of credit facility provided to the assessee by its bank.

If a person responsible for paying to the non-resident the amount of interest chargeable under the Act considers that the whole sum would not be chargeable, he has to make an application to the assessing officer under Section 195(2) of the Act. As held by the Supreme Court in Transmission Corporation (supra), the provision of section 195 under which the payer should deduct income tax on the amount paid to a non-resident is for a tentative deduction of income tax thereon, subject to regular assessment and by the deduction of income tax, the rights of the parties are not, in any manner, adversely affected. The rights of the payee or recipient are fully safeguarded under Section 195(2), 195(3) and 197 of the Act.

9.4 The effect of the deeming fiction that the income by way of interest payable by a person who is resident would be that the income deemed to accrue or arise in India, as envisaged by clause (v)(b) of section 9(1), will be treated to be arising in India irrespective of its being paid any where outside India. Simply by virtue of its becoming payable by the resident, the interest income of the type covered by clause (v)(b) of section 9(1) will be deemed to be accruing or arising in India, even if it is actually received by the non-resident outside India. If it is permissible for a non-resident receiving such interest income from a resident of India to contend that he has actually been disbursed the amount outside India and, therefore, such interest income did not accrue or arise in India, the provisions of section 9(1)(v)(b) will become wholly redundant. Such income is deemed to accrue or arise in India wherever it is payable by a resident. This means that irrespective of its being paid to the non-resident in the country of his residence or else where outside India, it is deemed to have accrued or arisen to him in India. Therefore, even if the sum which was payable to the non-resident by the resident assessee is paid by the mode of releasing a letter of credit and received by the non-resident outside India from the negotiating / intermediatory bank, such sum would be nonetheless income deemed to be accruing or arising to the non-resident in India. There is, therefore, no substance in the contention of the two learned Senior Counsel for the assessees that they had paid the money to the banks issuing the letters of credit and therefore, the assessees had not paid the sum to the non-residents and hence, no deduction was required to be made by the assessees under Section 195(1) of the said Act.

10. It was argued by the learned Senior Counsel for

the assessees that the letter of credit is an independent contract whereunder the issuing bank becomes the principal obligor to the seller in respect of the payment by letter of credit, and that the obligation of the buyer gets discharged on the day L.C. is delivered and such obligation taken over by the issuing bank is to be discharged by it as a principal on the 180th day at the end of the usance period. It was contended that if the issuing bank fails to pay, the seller can have no remedy against the buyer. In short, the interest amount was paid by the buyer to the issuing bank and not to the foreign bank or the seller which means no interest income arose or accrued in India and the buyer was not obliged to deduct tax therefrom under Section 195(1) of the Act. The contention was that the issuing bank was not acting as an agent of the buyer in effecting the payment under the L.C. and was acting as a principal. These contentions overlook the real nature of payment by a letter of credit which is one of the internationally recognized mode of payment through the banking medium for paying the consideration for purchase of goods. The letter of credit is a document issued by a bank as per instructions by a buyer of the goods, authorizing the seller to draw a specified sum of money under specified terms, usually receipt by the bank of certain documents, within a given time. In the present case, the MOA between the buyer and the seller stipulated that the payment was to be made by irrevocable letter of credit. The letter of credit issued complied with the conditions laid down in the MOA. The MOA did not specifically provide that mere issue of credit shall be absolute and final payment. Acceptance by the seller of a commercial credit constituting absolute payment which would debar him from his ordinary right to pursue the buyer if the seller did not receive payment under the credit has to be expressed in clear terms in absence of which the seller's rights against the buyer are not exhausted by the issue of credit (See "The Law of Bankers' Commercial Credit (7th Edition) by H.L. Guttridge & Maurice Megrah at pp. 35 and 36). The purpose of the system of confirmed irrevocable Documentary Credits developed in the international trade is "to give to the seller an assured right to be paid before he parts with control of the goods" (See Lord Diplock's Speech in United City Merchants (Investments) Ltd. and Glass Fibres and Equipment Ltd. v. Royal Bank of Canada, Vitrorefuerzos SA and Banco Continental SA, reported in (1982) 2 Llyod's Report 1 H.L.) Thus, in absence of a specific "absolute payment" clause when the letter of credit is issued and accepted by the seller, it operates as a conditional payment of the price (Lord Denning M.R. in W.L. Alan &

Co. (supra)). The buyer is not entitled to claim that he has performed his entire bargain by furnishing the required letter of credit and by remitting to the issuing banker the funds necessary for making payment. He is not discharged from his duty to pay the price to the seller, because, the buyer promises to pay by letter of credit and not just to provide by a letter of credit merely a source of payment which does not pay. (See para 34.425 of Chitty on Contracts, 28th Edition, Volume 2 at page 354, citing Marun Road Saw Mill v. Austin Taylor Co. & Ltd., reported in [1975]1 Lloyd's Report 156, 159; and E.D. & F.. Man Ltd. v. Nigerian Sweets and Confectionery Co. Ltd. reported in [1972] 2 Lloyd's Report 50). When it is agreed in the contract of sale that payment should be made by furnishing of a commercial credit, the seller has to claim payment from the bank in the first instance and only on the default being committed by the bank, from the buyer. "Authorities both in London and in the United States indicate that the buyers' obligation to pay the price of goods is not absolutely discharged by opening of the credit and that upon the banker's default, the seller can claim payment from the buyer" - (See para 34.423 at page 354 of Chitty on Contracts, 28th Edition, Volume 2). The commercial credit is addressed to the seller and states that, on the instructions of the buyer, the banker authorizes the seller to draw bills of exchange upto the stated amount. The opening of a confirmed letter of credit constitutes a bargain between the banker and the vendor of the goods, which imposes upon the banker an obligation to pay on the basis of mercantile usage recognized all over the world. Irrevocable credit constitutes an independent contract between the issuing banker and the seller, and it is not qualified by or subject to the terms of the contract of sale or the contract between the issuing banker and the buyer. The autonomy of banks undertaking is usually upheld by the courts' reluctance to interfere with the banking arrangement except under the fraud rule or illegality of the letter of credit itself, which constitute exceptions to the autonomy doctrine. (See, Chitty on Contracts paragraphs 34.433 to 34.437).

10.1 In order to avoid hard results from refusal to recognize contracts for the benefits of third parties as creating rights in the later, English Courts, as also American Courts have been and are increasingly straining to get away from the exclusive bargain theory and the requirement of consideration. Dean Roscoe Pound in his Jurisprudence, Volume III in Chapter 14 places fifteen such exceptions under four different heads. Under heading IV "Intention to be bound in a business

transaction" at page 212, in context of letters of credit, points out that letters of credit though not upon consideration are given effect when acted on, on the theory of estoppel or sometimes on a theory of consideration moving from a third person and the attitude of the courts not to interfere with them having regard to the norms adopted by the substantive institution of law merchant, in the following terms;

> "Letters of credit not under seal and not upon consideration are given effect when acted on. Sometimes this is done on a theory of estoppel, sometimes on a theory of consideration moving from a third person, and sometimes on a theory of an independent transaction of the law merchant requiring no consideration except between the immediate parties. As has been well said, "Throughout the cases we may note the courts feeling, more or less subconsciously, that we have here a substantive institution of the law merchant, which ought to be sustained on its own basis; and that whatever common law theories may be convenient for the purpose are to be resorted to in order to fortify it. It is significant that no deliberate written promise of a business man or commercial entity, made as a business transaction, to answer for credit extended on the basis of the writing has failed of enforcement in our courts."

11. The letter of credit, in the present case, as is usual, states that; "This credit is subject to the Uniform Customs and Practice for Documentary Credits (1993 Revision) - International Chamber of Law Publication No. 500". Under Article 2 of the U.C.P. (which applies to all Documentary Credits), Documentary Credit means any arrangement, however named or described, whereby the issuing bank at the request and on the instructions of a customer-applicant, is to make a payment to the third party beneficiary or to accept pay bills of exchange (Drafts) drawn by the beneficiary, or authorizes another bank to effect such payment or to accept such Drafts, or to negotiate against stipulated documents, provided that the terms and conditions of the credit are complied with. By Article 3, it is made clear that credits, by their very nature, are separate transactions from the sale or other contracts on which they may be based and banks are in no way concerned with or bound by such contracts even if a reference whatsoever to such contract is included in the credit.

Consequently, the undertaking of a bank to pay, accept and pay drafts or negotiate and/or fulfill any other obligation under the letter of credit is not subject to claims or defences by the Applicant (buyer in the present case), resulting from his relationship with the issuing bank or the beneficiary (seller in the present case). Under Article 9 of the U.C.P., an irrevocable letter of credit constitutes a definite undertaking of the issuing bank, provided stipulated documents are presented to the nominated bank or the issuing bank, and that the terms and conditions of the credit are complied with to pay, as provided by sub-clause (a) of Article 9, on the maturity dates determinable in accordance with the stipulations of the credit, if the credit provides for deferred payment (as in the present case), or to pay as per the contingencies mentioned in other clauses. Under Article 18(a)(b) of the U.C.P., banks utilizing the services of another bank for the purpose of "giving effect to the instructions of the Applicant" (the assessee - buyer in the present case), do so "for the account and at the risk of such Applicant", and banks assume no liability or responsibility should the instructions they transmit not be carried out, even if they have themselves taken the initiative in the choice of such other banks. By Article 18(d) of the U.C.P., it is made clear that the Applicant - customer (the assessee - buyer in the present case), shall be bound by and liable to indemnify the bankers against all obligations and responsibility imposed by foreign laws and usages. Even under the Uniform Rules for Collection (ICC No.322), the customer entrusting the operation of collection (which means handling by banks, on instructions received, of documents as defined in the definition clause which includes commercial documents), is the "principal" under whose instructions the remitting bank to whom the principal has entrusted the operation of collection, will utilize the collecting bank "for giving effect to the instructions of the principal" (i.e. the customer) as provided in Article 3, and, "banks utilizing the service of other banks for the purpose of giving effect to the instructions of the principal do so for the account of and the risk of the later". Under Article 4 of these Rules, banks concerned with collection assume no liability or responsibility for the consequences arising out of delay and / or loss in transit of letters or documents.

11.1 The buyer, therefore, does not get absolved from his contractual liabilities under the contract of sale or from his statutory liabilities, such as, of making deduction of tax at source under Section 195(1) of the Act while making payment by the mode of a letter of

credit. The seller, in absence of any contrary stipulations, accepts the mode of payment by a letter of credit on an understanding that the Drafts drawn by him on the letter of credit will be honoured. Issuance of the confirmed irrevocable letter of credit is an assurance to him that he will get the payment for the goods sold by drawing on the letter of credit, but it would be only a conditional payment, the condition of its acceptance being that the amount will be realised on the basis of the credit released in his favour. There was no stipulation in the MOA that the letter of credit by itself was accepted by the seller as an "absolute payment". It was therefore a conditional payment and in such a case, when by reason of the dishonour of the drafts drawn by the seller on the letter of credit or the failure of the letter of credit, the condition on which the letter of credit was received by the seller is not fulfilled, the seller would be an "unpaid seller" within the meaning of section 45(1)(b) of the Indian Sale of Goods Act (similar to section 38(1)(b) of the U.K. Sale of Goods Act, 1979), and be entitled to claim the price from the buyer under Section 55 of the Indian Act (similar to section 49 of the U.K.Act), and his remedies against the goods would revive.

11.2 The issuing bank acts at the request and on the instructions of the buyer and thereby acts on behalf of the buyer to pay the seller the amount on presentation of the documents as per the stipulations in the letter of credit. It is only a banking arrangement to effect payment and has nothing to do with the statutory obligations of the buyer which continue to bind the buyer in respect of the income by way of interest and other sums that are deemed to accrue or arise in India in favour of the non-resident seller. The contention that obligation of the buyer was taken over by the issuing banker when the letter of credit was delivered and therefore, there was no duty on the part of the buyer to make deduction at source of the tax under Section 195(1) of the said Act is, therefore, misconceived and unwarranted.

12. Then comes the contention that if the sum paid by release of the letter of credit to the non-resident is to be deemed to be income accrued or arisen to him in India, then it was not in fact "interest" and was part of the price of the ship purchased and therefore, no tax was required to be deducted from such amount under Section 195(1) by the buyer. The argument runs thus: The amount of usance interest though described as interest in the MOA was not interest as contemplated by section 2(28A) of

the Act. The price of the goods would consist of costs of material, labour costs, costs of finance and profit. Though price would be the sum total of these items, payment made for the goods is not payment towards any of the components that go in to the fixation of the price. It is submitted that the MOA itself recognizes interest as a part of the purchase price by making the whole amount payable thereunder, including the so called interest, at the end of the usance period of 180 days. When the principal amount of the price of the ship itself was payable at the end of 180 days from the date of delivery, no price was due and payable on the date of delivery and therefore, there could arise no question of interest to start running from that date, argued the learned Senior Counsel. The interest amount was fixed and made payable alongwith the price of the ship at the end of the usance period and the buyer had no option to pay it earlier and therefore also, it was, in fact, not interest and was part of the full purchase price, which was for convenience sake, split-up into two invoices, one of the purchase price and the other of the usance interest, according to the learned Senior Counsel. Moreover, in the event of breach of contract on the part of the buyer, for computing damages, the measure stipulated was the basis of the entire amount payable as purchase price, which according to the learned counsel, showed that the interest was part of the price of the ship.

12.1 The MOA dated 14th July 1994 by which the ship "Global Hope" was purchased by the buyer for demolition from the non-resident seller incorporates the following conditions as regards the price and its payment in clauses (1) and (2) :

"1. PRICE : U.S. $ 66.06 per long ton (excluding of interest for 180 days from the date of tendering NOR) of light displacement tunnage excluding permanent ballast, net L.D.T. being 18483.78 long tons excluding permanent ballast. Total price : US $ 30,69,416.51 (United States Dollars Three Million Sixty Nine Thousand Four Hundred Sixteen and Cents Fifty One Only) and interest for 180 days from the date of NOR 7.25% per annum, separate invoice and drafts to be prepared for the original price and for the interest amount.

2. The total amount with interest shall be payable :-

By means of 100 per cent confirmed irrevocable 180 days usance letter of credit with confirmation charges at seller's cost and acceptable to sellers through any nationalised Indian bank (hereinafter called the Opening Bank) to be established in favour of the sellers for the nett amount by 19th September, 1994."

Thus, original price of the ship fixed was US $ 30,69,416.51 (excluding interest). The interest for 180 days from the date of tendering the Notice of Readiness (NOR) was calculated at the rate of 7.25% on the said original price of the ship from the date of the NOR. The invoices and drafts of the original price and the interest amount were to be separately prepared and were in fact separately prepared. The commercial invoice certified the details of the vessel and its purchase price at US $ 30,69,016.51 as per the MOA dated 14-7-1994 (See page 30 of the appellant's paper book - similar commercial invoice of two other ships at pp. 33 and 34 of paper book 1 in Tax Appeal No. 348 of 2002). It will also be seen that, admittedly, the buyers paid customs duty on the purchase price of the ship excluding the interest amount. Thus, not only the invoices of the purchase price of the ship and the interest amount were to be separately prepared, the customs duty which was payable for the buyers account as per clause (21) of the MOA was paid on the purchase price of the ship excluding interest. The intention of the parties to the contract was, thus, clear and the price of the ship was considered to be separate as certified in the invoice, which reflected its price agreed in the MOA, and, the buyer in lieu of the credit facility of 180 days from the date of the NOR was required to pay interest at the rate stipulated in the MOA and worked out thereunder for which a separate invoice was prepared. It is also significant to note that the price of the ship was separately calculated on the basis of US $ 166.06 per long ton in the MOA relating to `Global Hope' and the total price of net L.D. Tonnage of 18,483.78 was worked out at that rate to be US $ 30,69,416.51. The interest amount was worked out on that total price and the interest rate and time of 180 days fixed for the credit facility. This means that there was no nexus between the interest amount and fixation of the price of the ship which was on tonnage basis. The nexus of interest was only with the period from which the purchase price of the ship became

due on Notice of Readiness or Delivery. In clauses 15(D) to 15(E) of the MOA, measure of damages due to default of the buyer in payment or the seller in the execution of the bill of sale or in delivery was fixed at 20% of the purchase price of the ship, which as per the commercial invoice dated 22-9-1994 was US $ 30,69,416.51 as per the MOA dated 14-7-1994 and as certified by the seller in that invoice. This clearly indicates that interest amount covered under the separate invoice was not a part of the purchase price though it was payable alongwith the purchase price by means of 180 days usance confirmed irrevocable letter of credit. The plea that the usance interest amount should be treated as part of the price is, therefore, clearly an afterthought of these buyers and cannot be countenanced being against their positive conduct and terms of the contract of sale.

13. As per clause (2) of the MOA, the total amount with interest was payable by confirmed irrevocable 180 days usance letter of credit with confirmation charges at seller's costs and acceptable to sellers through any Nationalized Indian Bank, to be established in favour of the sellers for the net amount by 19-9-1994. The letter of credit was to be released to the sellers "immediately after the Notice of Readiness had been given by the buyers and upon presentation to the negotiating bank of the documents mentioned in clause (3), which included signed commercial invoice certifying details of the vessel and the purchase price of US $ 30,69,416.51 and a signed invoice for the interest amount of US $ 1,09,742.15 for 180 days usance from the date of NOR, as was stipulated in the MOA dated 14-7-1994. In clause (6) of the MOA, it was stipulated that the vessel with everything belonging to "Her" shall be at seller's risk and expenses, until she is delivered to the buyer. If before delivery the vessel became "total constructive loss", the contract was to be considered as null and void and the letter of credit to be immediately released to the buyers as per clause (14) of the MOA. These stipulations show that the purchase price became payable on the delivery being effected as per the NOR when the risk passed to the buyer. Under Section 20 of the U.K. Sale of Goods Act, 1979 (similar to section 26 of the Indian Act), the property in the ship was transferred to the buyer, prima facie with the passing of the risk.

14. The definition of "interest" in section 2(28A) of the Act was inserted w.e.f. 1-6-1976 by the Finance Act, 1976. `Interest' means interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or

obligation) and includes any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilized. The meaning of the word "interest" is, thus, very wide and would include interest on unpaid purchase price payable in any manner which would include payable by means of irrevocable letter of credit. The claim of the seller to the price of the goods sold normally arises when the property is transferred to the buyer. The seller gets a right to get the price of the goods and the buyer has a corresponding obligation to pay it, both as per the contract of sale and under the law. Therefore, debt is incurred by the buyer of the purchase price which he is obliged to pay. The debt arises from the unwillingness or inability to pay cash down when the purchase price becomes payable against delivery, and the engagement to pay it at a later date or by installments. (See Jurisprudence by Roscoe Pound, Part III, at p. 176).

14.1 Under Section 28 of the U.K. Sale of Goods Act, 1979 (corresponding to Section 32 of the Indian Act), unless otherwise agreed, delivery of goods and payment of the price are concurrent conditions. The seller gets a right to sue for the price when property in goods has passed under Section 49 of the English Act (similar to section 55 of the Indian Act). Thus, when the price became payable on transfer of the property in the ship when the risk passed on delivery, the seller became entitled to the purchase price payable by the buyer to him and in respect of such debt incurred, interest at the stipulated rate for the usance period was calculated from the date of the transfer of the property in the ship to the buyer till the end of the period of credit facility of 180 days given to the buyer for effecting the payment of the purchase price. When the price of the ship which became due on the property being transferred was to be paid under the contractual arrangement at the end of the usance period of 180 days and interest was calculated thereon, by the very nature of such contractual arrangement, both the principal amount and interest calculated for the credit period fixed were required to be paid together as per the usance letter of credit. When payment is made by negotiable instrument or by a letter of credit which is normally regarded as conditional payment, only the remedy of the seller to sue for price is suspended and not his right or claim to the price of the goods, which arises on the transfer of property in the goods.

14.2 In England, statutory interest may be payable

under the Late Payment of Commercial Debts (Interest) Act, 1998 on debt created by virtue of obligation to pay the whole or part of the contract price. Under Section 1 of the Act, it is provided that it is an implied term in a contract to which the Act applies that any qualifying debt created by the contract carries simple interest. Such statutory interest shall be treated, for the purpose of any rule of law or enactment relating to interest on debts, in the same way as interest carried under an expressed contractual term. That Act applies to a contract of sale of goods and section 3 thereof provides that a debt created by virtue of an obligation under such contract to pay the whole or any part of the contract price is a "qualifying debt" for the purposes of the Act. Even under Article 78 of the United Nations Conventions on Contracts for the International Sale of Goods Act, 1980 (CISG), if a party fails to pay the price or any other sum that is in arrears, the other party is entitled to interest on it without prejudice to any claim for damages recoverable under Article 74 thereof. Under Article 53 of that Convention, the buyer must pay the price for the goods and take delivery of them as required by the contract and the said Convention. By Article 54, it is provided that the buyer's obligation to pay the price includes taking such steps and complying with such formalities as may be required under the contract or any laws and regulations to enable payment to be made. Under Article 59, the buyer must pay the price on the date fixed by or determinable from the contract and the Convention, without the need for any request or compliance with any formality on the part of the sellers. By Section 54 of the English Sale of Goods Act and Section 61 of the Indian Act, the right of the buyer or the seller to recover the interest is saved. Under Section 61(2), in absence of a contract to the contrary, the Court may award interest at such rate as it thinks fit on the amount of the price to the seller in a suit by him for the amount of the price, from the date of the tender of goods or from the date on which the price was payable. We may note that the word "debt" is defined in section 2(c) of the Interest Act, 1978, inter alia, to mean any liability for an ascertained sum of money. The price payable under the MOA for the ship was an ascertained sum of money which the buyer had undertaken to pay for the purchase of the ship. Thus, it would be too farfetched to urge that unpaid purchase price of sale of goods is never a debt incurred and no interest can accrue thereon. Here, the contract of sale itself has considered the purchase price of the ship as payable on delivery after Notice of Release, and that is why the interest is computed at the rate agreed for the usance

period of 180 days being the credit facility given to the buyer. Such contractual arrangement is perfectly valid and the parties have themselves stipulated payment of interest on the purchase price of the ship considering it to be a debt incurred by the buyer from the date of delivery when the risk passed to the buyer and with it, the property in the ship.

15. Furthermore, as per the Accounting Standards, revenue from sale of goods is recognized when the seller transfers the goods to the buyer for consideration. Under the International Accounting Standard 18 relating to revenue recognition, revenue should be recognized in sale of goods when:

(i) Significant risks and rewards of ownership are transferred to the buyers,

(ii) Managerial involvement and control have passed,

(iii) The amount of revenue can be measured thereby, and,

(iv) the costs of the transaction (including future costs) can be measured reliably.

Interest revenue is recognized on a time proportionate basis using the effective interest rate.

Accounting Standard 9 issued by the Institute of Chartered Accountants of India of "revenue recognition" relating to transactions involving sale of goods as contained in paragraphs 10 and 11 read as under :

"10. Revenue from sales or service transactions should be recognised when the requirements as to performance set ut in paragraphs 11 and 12 are satisfied, provided that at the times of performance it is not unreasonable to expect ultimate collection. If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed.

11. In a transaction involving the sale of goods, performance should be regarded as being

achieved when the following conditions have been fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

xxx xxx xxx"

Interest revenue is to be recognized on the following basis as per para 13 of Accountant Standard 9 :

"13. Revenue arising from the use by others of enterprise resources yielding interest, royalties and dividends should only be recognised when no significant uncertainty as to measurability or collectability exists. These revenues are recognised on the following bases.

(i)Interest: on a time proportion basis taking into account the amount outstanding and the rate applicable;

xxx xxx xxx"

15.1 It is obvious that if the payment of the sale price of the ship which was revenue to be recognized at the time of transfer of "significant risks and rewards of ownership" to the buyer was to be made at the deferred date, the buyer would be entitled to use the amounts due to the seller for the usance period, and interest accrued thereon on the time basis determined by the amount of the price outstanding and the rate applicable which were duly worked out in the contract itself. The parameters, that is, time proportion, the amount of the purchase price of the ship which became outstanding when the property in the ship was transferred to the buyer on delivery with all risks and the rate of interest were all agreed

between the parties and interest amount was specifically worked out on the purchase price of the ship for the usance period. These are not the cases where the total amount payable under the MOA included a mere estimate of interest loss made as an integral part of the purchase price on incremental basis. These are the cases in which there exist conscious and deliberate stipulations of purchase price of the ship and the interest amount specifically calculated at the agreed rate for the period fixed. Thus, there is absolutely no scope for contending that the outstanding price of the ship was not a "debt incurred" within the meaning of section 28A of the said Act or not a "debt claim" under the Article concerning taxation of interest in the Double Taxation Avoidance Agreements, on the date of delivery or that the interest payable thereon under the contract was part of the purchase price or incremental price of the ship, as contended on behalf of the assessees.

15.2 The observations of the Supreme Court in Keshav Mills Ltd. (supra), to the effect that the relationship of the vendor and the purchaser is not metamorphosed in to that of creditor and vendor cannot be construed to mean that outstanding unpaid purchase price of the goods, is not a debt. All that the Supreme Court has said is that the vendor vendee relationship is not metamorphosed into creditor and debtor, meaning thereby, that it is not totally transformed into a creditor and debtor relationship. This only means that their rights and liabilities as vendor and vendee continue to exist even after the debt becomes outstanding. That is why, it was held that the vendor could not say that he is under no further obligation to the purchaser and that the purchaser must pay the price of the goods debited to him as a debt arising out of the book entry. The Supreme Court, while explaining the mercantile system of accounting held that it brings into credit, what is due, immediately becomes legally due and before it is actually received and it brings into debit expenditure amount for which a legal liability has been incurred before it is actually disbursed. Distinguishing Keshav Mills Ltd. (supra), the Supreme Court in Standard Triumph Motor Company Ltd. v. C.I.T., reported in 201 ITR 391, held that the credit entry to the account of the non-resident assessee in the books of account of the Indian Company would amount to receipt by the non-resident company and is accordingly taxable.

16. The last limb of the argument that the assessee was not liable to deduct tax at source on the interest payable to the non-resident under the MOAs, was that such

amount was not interest within the meaning of the DTAAs and was part of business profit of the non-resident and therefore, taxable in the other contracting States. The DTAAs, between India and Great Britain, and, India and Singapore, copies of which are at items 8 and 9 of the paper book of the appellant in Tax Appeal No. 273 of 2002 and which appear in 209 ITR (Statutes) at page 1 (with Singapore); and 206 ITR (Statutes) at page 235 (with United Kingdom of Great Britain, (Similar DTAAs are with U.S.A. in 178 ITR (Statutes) 44, Germany in 223 ITR (Statutes) 130, United Arab Emirates 205 ITR (Statutes) 49, Cypress in 218 ITR (Statutes) 70, and Belgium in 228 ITR (Statutes) 79), provided in the Article concerning the taxation of business profits that the business profits of an enterprise of a contracting State shall be taxable in that State unless non-resident carries on business in the other contracting State through a permanent establishment situated therein. It is, however, specifically mentioned that "where profits include items of income which are dealt with separately in other Articles of the Agreement, then the provisions of those Articles shall not be affected by the provisions of this Article". Article 11 of the DTAA with Singapore and Article 12 of the DTAA with the U.K. deal with "Interest" and provide in Clauses (1) and (2) that interest arising in a contracting State and paid to a resident of the other contracting State may be taxed in that other State. However, such interest may also be taxed in the contracting State in which it arises, and according to the laws of that State, but if the beneficial owner of interest is resident of the other contracting State, the tax so charged shall not exceed the percentage of the gross amount of the interest specified therein. The term "interest" as used in these Articles of the said two Agreements means "income from debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits." (emphasis added). The relevant part of the said Article concerning taxation on interest contained in the DTAAs reads as under :

"Art.11: Interest:

1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, such interest may also be taxed in the Contracting State in which it arises, and according to the laws of that

State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed:

(a) 10 per cent of the gross amount of the interest if such interest is paid on a loan granted by bank carrying on a bona fide banking business or by a similar financial institution (including an insurance company);

(b) 15 per cent of the gross amount of the interest in all other cases.

3. The term "interest" as used in this Article means income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits; and in particular, income from Government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment shall not be regarded as interest for the purpose of this Article.

xxx xxx xxx"

17. The DTAAs follow the pattern of the Organization of Economic Cooperation and Development (OECD) Model Convention. The Model Convention has been used by the covenanting States as a basic document of reference while entering into such bilateral treaties. Such double taxation avoidance treaties are international agreements. Section 90 of the said Act enables the Central Government to enter into such Agreement with the government of another country, inter alia, for relief where income tax is paid in both countries or for avoidance of double taxation. Under sub-section (2) of section 90, it is provided as under :

"Agreement with foreign countries :

"90.

(1) xxx xxx

(2) Where the Central Government has entered into an agreement with the Government of any country outside India under sub-section (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee."

By virtue of sub-section (2) of section 90, the provisions of the Income Tax Act will apply to the extent they are more beneficial to the assessee. This would mean that the provisions of the Agreement will apply and if the provisions of the Act are more beneficial than the provisions of the DTAA, then those more beneficial provisions will apply. Impact of this provision is to make treaty prevail over the Act with an additional advantage of applying more beneficial provisions of the Act.

17.1 A formula reserving the exclusive taxation of interest to one State, whether the State of the beneficiary's residence or the State of source was not sure of general approval. Therefore, Article 11 of the Model Convention concerning the taxation of interest adopted a compromise solution providing that interest may be taxed in the State of residence but leaves to the State of source of income the right to impose a tax, if its laws so provide, it being implicit in this right that the State of source is free to give up all taxation on interest paid to non-residents. Its exercise of this right will however be limited by a ceiling which its tax cannot exceed. (See OECD Commentary on Article 11 of the Model Convention - Preliminary remarks in para 11C.03).

18. As per OECD Commentary (para 11C.06), the term "paid" in paragraph 1 of the Article concerning taxation of interest has a very wide meaning "since the concept of payment means fulfilment of the obligation to put funds at the disposal of the creditor in the manner required by contract or by custom". Payment would therefore mean the fulfilment of the claim to receive interest in whatever form it may actually occur (See Klans Vogel on Double Taxation Convention, 3rd Edition at page 714). Thus, payment of interest by means of irrevocable letter of credit by the buyer will be considered as an interest paid to the seller. Article 11(2) of the Model Convention lays down nothing about the mode of taxation

in the State of source. This Article does not deal with procedural aspects of tax collection. It therefore leaves that State free to apply its own laws and, in particular, to levy tax either by deduction at source or by individual assessment. Referring to the definition of "interest" in para 3 of Article 11 of the Model Convention, which is the definition adopted in the DTAAs between India on one side and U.K. and Singapore and other countries on the other, the OECD Commentary in para 11C.21 records that the definition of `interest' is, in principle, exhaustive and covers practically all the kinds of income which are regarded as interest in the various domestic laws and that the formula employed offers greater security from the legal point of view and ensures that Conventions would be unaffected by future changes in any countries in domestic law." The expression "debt claims of every kind" cannot, therefore, be whittled down to mere debt claim in form of loans. The addition of the words "including interest on deferred payment of sales", in the parenthesis after the words "debt claim of every kind" in the DTAAs with Indonesia (reproduced in 171 ITR (Statutes) 27 at page 35) or the words to the same effect in the DTAA with Philippines (reproduced in 219 ITR (Statutes) 60, relevant page 71), is, in our view, only explanatory and makes explicit that what is implicit in the phrase "debt claims of every kind", to prevent unnecessary arguments of the type raised by these assessees. Even the Model Convention did not contain such words that amplify the meaning of the expression "debt claims of every kind". In the present case, the purchase price of the ship became outstanding on the date of its delivery and since it was not being actually paid cash down against delivery, interest was contractually charged thereon at the specified rate for the usance period. Thus, by the very intention of the parties reflected in the MOA and their conduct, the interest amount was agreed to be paid treating the purchase price as a debt claim that arose when the purchase price became payable against delivery. The contractual interest on the debt in the form of the outstanding purchase price of the ship, which revenue was to be recognized, as per the MOA and the provisions of the Sales of Goods Act as well as Accounting Standards, from the date of delivery of the ship, was the amount that would aptly fall in the expression "debt claims of every kind". This was not a case where the vendor gave the goods to the buyers on credit at a lumpsum price to be paid in future in which the interest element could not be definitely identified, but it is a case where the price became outstanding under the MOA on the date of delivery and the interest was agreed to be paid on the

debt that was incurred in form of the unpaid purchase price that was treated as debt outstanding. The interest, in the present case, having regard to the nature of contract and the intention of the parties reflected from their conduct of treating purchase price and interest separate for all purposes including payment of customs duty and accounts, has no element whatsoever of the selling price of the ship. The contention that the interest payable to the non-resident under the MOAs was part of the purchase price of the ship, therefore, fails both on facts and in law.

19. The decision of the Andhra Pradesh High Court in C.I.T. (A.P.) v. Vishakhapatanam Port Trust (supra) was rendered in the context of liability to pay tax on the basis of DTAA and the case of the German Company was that it had no "permanent establishment" in India and therefore, since section 9(1)(i) of the said Act was subject to the DTAA, it was not taxable in India, but in the other contracting State. The assessments in that case related to the years prior to the introduction of section 9(1)(v) in the Act w.e.f. 1-6-1976 under which by a deeming fiction interest, such as usance interest payable by a resident, would be deemed to accrue and arise in India. Therefore, the said decision of the Andhra Pradesh High Court cannot assist the assessees. It will be noticed that Article VIII concerning taxation on interest in the DTAA with Germany existing at that time was worded differently from the Article concerning taxation of interest of the revised Model Convention 77 and the DTAAs relevant to the present cases followed that Model Convention which included the expression "debt claim of every kind" in the Article concerning taxation of interest which expression was absent in the said clause VIII of the Agreement with Germany. The decision of the Andhra Pradesh High Court was, therefore, rendered in a different context. We are, however, for the foregoing reasons unable to subscribe to the view that the outstanding purchase price of goods is not a debt.

20. The Article of the DTAAs concerning the taxation of interest does not deal with the procedural aspects of tax collection. The mode of tax collection including by deduction at source as provided under Section 195(1) read with section 4(2) of the Act which enjoin a duty on these assessees who were responsible for paying to the non-residents usance interest, to deduct income tax thereon at the time of credit to the payee's account or at the time of payment by means by irrevocable letter of credit whichever was earlier could be validly enforced against them and having failed in making deduction of

income tax on the interest paid by them to the non-residents, they cannot claim any deduction of the amount in respect of such interest which was payable outside India, in view of the provisions of section 40 of the said Act. The finding of the Tribunal that the assessees were not liable to deduct tax at source from the said payment of interest and that disallowance of interest under Section 40(a)(i) of the Act was not warranted, is, therefore, obviously erroneous.

21. The reasoned order of the Tribunal on the question whether ship breaking activity gives rise to manufacture and production of altogether different articles or things and hence, the applicant is entitled to deduction under Section 80HH and 80I of the Act, which has been followed by it in other cognate matters, is contained in Tax Appeal No. 196 of 2001. The Tribunal followed the decision of the Bombay High Court in Ship Scraps Traders (supra) holding that the ship breaking activity gives rise to manufacture and production of altogether new commercial articles or things which are commercially identifiable in the commercial world other than the ship, and therefore, the assessees should be held entitled to claim of deductions under Sections 80HH and 80I of the Act. The Bombay High Court distinguished its earlier judgement in C.S.T. v. Delhi Iron & Steel Co. (supra) in which it was held that no process of manufacture was involved when after purchase of an old ship, the assessee dismantled the same and sold the scrap material obtained from the dismantled ship. Even in ship scraps Traders Case (supra), an old ship was bought for the purpose of demolition and the ship was dismantled. The Bombay High Court, however, distinguished its earlier judgement on the ground that the ship was in that case condemned and unserviceable. The Tribunal relied upon the above judgement of the Bombay High Court, observing that since the ships were new and in good working condition because they remained afloat, it followed the said decision.

22. New ships are not meant for demolition or breaking. It is after the operative and useful life of the ship is over that they are scheduled to be sold for demolition. The procedure for demolition of a ship is not just a private affair and involves permission of the authorities under the law to transfer them for demolition. Merely because the ship is able to sail on its own upto the shore where it is to be demolished, it cannot be said that such ship which is sold for demolition is a new ship. Remaining afloat is not a sure test for a ship to be called new, because, a condemned

ship is not always a sunk ship. An old ship sold for demolition that manages to remain afloat cannot be said to be a new ship. The distinction made on that count is a distinction attempted without any real difference between the old ships which are sold for demolition, for the purpose of considering whether the ship breaking activity is a manufacturing or production activity. The contention of the learned counsel for the assessees was that the activity of the ship breaking was a production activity by which new articles came into existence by dismantling the ship which was a systematic process requiring skill and expertise and expensive machinery was used for demolition of a ship. It was also attempted to argue that ship breaking was a manufacturing activity and for this, reliance was placed on several decisions in Sales tax Cases which centered around the definition of "manufacture" in the sales tax laws of various States. Reference was also made to the Factories Act, 1948 to point out that "breaking up or demolishing" any article with a view to its use, sale etc. was, "manufacturing process" as defined in section 2(k) of that Act. Literature was shown for pointing out the type of articles and things that come out of the broken old ships. An ingenious argument was canvassed by the intervening learned counsel that if by assembling different articles (parts) one is said to manufacture an automobile, then why should it not be considered as manufacture when by the reverse process of disassembling the automobile its parts are brought into existence. In short, both the "birth" and the "death" of a ship should be construed as manufacture or production activity. One of integration into a ship and the other of its disintegration into the articles that went into its making. The assessees have the advantage of making these arguments, because, the expression "manufacture and production" of articles or things is not defined for the purposes of sections 80HH or 80I of the Act. The cases based upon sales tax, factory or excise laws where there is definition of `manufacture' or `manufacturing process' will have to be viewed in the context of and purposes underlying those laws and in light of the definition of manufacture tailored to achieve those purposes.

23. By the nature of its very setting, one has to construe the expression "manufacture or produce articles" in sub-section (2)(i) of section 80HH and the expression "manufactures or produces any article or thing not being any article or thing specified in the list in the Eleventh Schedule", appearing in section 80I(2)(iii) in the context of the fact that the deduction under Section 80HH is meant to encourage establishment of new

industrial undertakings in backward areas when such industrial undertaking `has begun or begins to manufacture or produce articles' and in context of the fact that section 80I is designed to encourage industrial undertakings to manufacture or produce "any article or thing, not being article or thing specified in the list in the Eleventh Schedule". The Eleventh Schedule enumerates articles such as steel furniture, office machines and apparatus, gramophones, toilet preparations etc. and things like aerated waters with blended concentrations, confectionary or chocolates. The excluded items give an idea of what is meant by the legislature when it refers to "articles and things" in section 80I(2) of the Act. If the contention of the deceased is tested in context of an article of steel furniture, such as, steel table which would fall in the list of the excluded items in the Eleventh Schedule, the result would be that the benefit of section 80I will not be available while making a new steel table, but will be claimed when that steel table is dismantled and cut into scrap, on a specious plea that by the process of cutting the table, new articles such as handles, rods and sheets from which the table was made are brought into existence. Provisions of Article 80HH or 80I are meant for the benefit of industrial undertakings that carry out the activity of manufacture or production of articles or things and not for the scrap merchants who trade in buying old articles or things and take out their parts to sell them separately. All large scale junk dealers in discarded old and scrapped vehicles who might fish out a horn in working condition from such vehicle or pull out its steering wheel or part of its engine that may have a demand in the market of second hand spares will proclaim themselves to be manufacturers or producers of articles or things. No such startling result is intended by the provisions of sections 80HH and 80I, having regard to their underlying purpose of encouraging industries for being set up for manufacture or production of new articles or things. In fact, industrial undertaking formed by transfer of machinery or plant previously used for any purpose is disentitled to such benefits both under sections 80HH (2)(iii) and 80I(2)(iii) of the Act.

24. Ship breaking is undoubtedly an industry in which there is great earning potential despite environmental hazards which have prompted the developed countries to shun it and forward their vessels for demolition to the countries where labour is cheap and concern for environment and health hazards is yet to gather its due momentum. The pollution aspects of ship breaking are enumerated in para 2.13 of the Report of the Ferrous

Scrap Committee of the Government of India published in August 1997 which was referred to by the learned counsel for the assessees during their arguments. Recently, criticism has been voiced in some rich OECD countries that ship owners assume no responsibility for the often very toxic substances long contained in their roughly 30 years old vessels. Instead, the owners sell the ship as pure steel to Asia and make a good profit on this, while fully aware that the unsuspecting people there will be directly exposed to the hazardous substance; fully aware, too, that the authorities there do not meet their obligations to protect their citizens, be it out of negligence or incapacity.(See "Ships for scrap steel and toxic wastes for Asia. The health & environment hazards in recepient States, fact finding mission to the Indian Ship Breaking Yards in Alang and Bombay in October 1998" Authors Dipl.-Ing, Judit Kanthak, Andreas Berrstorff, published by Green Peace e.v. Hamburg, Germany).

24.1 The Regulations of the Gujarat Maritime Board under the Gujarat Maritime Board Act, 1981, are the regulations made for safety and welfare of workers as a measure of precautions during the cutting operations in the ship breaking yards and reliance on them does not advance case of the assessees on the aspect of manufacture or production. In fact, ship breaking activities are defined in Regulation 2(viii) as, all activities from beaching, cutting and other activities till dismantling of the ship, and the despatch of the dismantled materials from the ship breaking yard and not as any manufacture or production activity.

25. The MOAs in the present matters clearly indicate that the old ships were purchased by the assessees for demolition purpose. The registration of the ships was cancelled and the deletion certificate showing cancellation of registration was to be forwarded to the buyers as undertaken in para 3(viii) of the MOA dated 14-7-1994 of `Global Hope' and Part 3(vii) of the MOA dated 15-10-1993 of Kraszovodsk. The vessels were sold under these MOAs. "with everything belonging to her on board" and for demolition. In para 24 of the MOA dated 14-7-1994, it was stipulated that "Buyers agreed and warrant that vessel shall be broken up and not used for further trading of any kind". Admittedly, all the vessels purchased by the assessees of all these appeals were for ship breaking activities i.e. for dismantling them and removing dismantled material from the plots allotted to them for the purpose.

26. The rates of customs duty payable on the vessels

imported for breaking up (which fall under item 8908 of the Customs Tariff) was much lower (5%), than the rates for other vessels (40%). The ships imported for breaking up are obviously old ships, purchased to retrieve the material, particularly steel plates, for disposal in the market for re-rolling or re-cycling purposes which is not the activity done by these ship breakers in the process of ship breaking. The publication of Ferrous Scrap Committee Report, Ministry of Steel, Government of India entitled " Ship Breaking Industry present status in India and its impact on environment", relied upon by the learned counsel for the assessees (excerpts of which are in the compilation in Tax Appeal No.196 of 2002) records in para 02.05.02 that ship breaking consists essentially the activities of preparation for breaking up (including mouring / beaching), breaking down to big blocks, small blocks and sections, with handling, hoisting, cutting and shipping equipment. The sequence of ship breaking activities generally followed in beaching methods is enumerated in para 02.05.06, as under :

"Different methods of dismantling large ships and for reclaiming metals from broken-up ships have been evolved over the years in various countries depending on the availability of berthing/beaching facilities with a view to achieve speed and ease of recovery.

xxx xxx xxx xxx xxx xxx"

02.06 THE SHIPBREAKING PROCESS AT ALANG :

xxx xxx xxx xxx xxx

The sequence of shipbreaking activities generally followed in beaching method are :

* Ballast water, fuel oil and lubricants that can be pumped out are removed.

* Super structure items like cabins, furnitures, life boats, loose cables, firefighting equipments, ladders, window panes and frames, doors, fittings etc. are dismantled.

* Stores and movable gears including electrical navigation equipments nylon

and steel ropes shackles, pulley blocks, tarpaulin, paint and lubricant tins, machinery spares etc. are removed.

* Some of the winches, masts and derricks which are useful to manipulate cutting operations are removed.

* The ship hull is cut vertically into 3 to 10 ton blocks by oxygen-LPG torches. The hull cutting area is first cleaned manually by wire brushes and chippers before cutting. If the plates are rivetted, as in some ships aged more than 30 years, rivets are removed by gas-cutting orches or hammer and chisels. These blocks including those knocked down on to the beach are removed to the shore by winches.

* Auxilliary equipment of the prime mover machinery like diesel generator sets, boilers, air compressors, pumps, valves, etc are dismantled and removed.

* The main engine is dismantled in parts head, main block, piston, crankshaft and base. Bigger chunks of the engine are removed only when the engine room is exposed after cutting bulkheads of the hull.

* Bunker oil that cannot be pumped out in the beginning and that is stored under cargoholds is removed simultaneously with the engine dismantling.

* The propeller is cut from its shaft and removed.

* Large ships requiring deep draft even in light displacement condition may need to be rebeached by pulling the residual part of hull closer to the shore during the next high tide around the full moon day or the new moon day.

xxx xxx xxx"

26.1 Under the heading Recovery of different items

from ship breaking, items obtained after breaking are described as under :

02.08 RECOVERY OF DIFFERENT ITEMS FROM SHIP-BREAKING :

02.08.01 Items Obtained After Breaking

"Major items which are obtained after breaking are rerollable scrap, melting scrap, cast iron scrap, non ferrous metal, machinery, wooden furnitures, etc. Though, the amount of these items obtained on breaking varies with the size (LDT) and type of ships, but an average figure has been worked out based on questionnaire survey and is given in Table 2-4.

Larger the size of the ship lesser will be the percentage of non-ferrous metals, machinery, wooden furniture and cast iron and accordingly higher the percentage of re-rollable steel scrap. Ships built from 1970s onwards will contain less percentage of non-ferrous metals, machinery, wooden furniture and cast steel and fibre glass."

27. Thus, there is nothing whatsoever in the process of ship breaking activity which can be termed as manufacture or production of any article or thing. The dismantled material was already existing as a component of the old ship. The process of extracting steel plates from it while dismantling the ship will not make such extraction of existing material an activity of manufacture or production of such material nor will the process of cutting extracted steel plates for convenient disposal be manufacture or production of such steel plates. Merely because the ship breaking is considered as an industry, it would not be an industry engaged in manufacture or production of any article or thing. Benefit of the provisions of section 80HH and 80I is clearly not intended for such ship breaking activities which do not result in bringing into existence any new article or thing. The word "manufacture" in the context of sections 80HH and 80I of the Act would mean making of articles or things. While dismantling the ship, steel plates are not made but only removed which is not the same thing as making of steel plates. The word "production" in context of these provisions would mean the action of making or manufacturing from components or raw materials an article or thing and not just removing existing article or cutting it. The Supreme Court in Indian Poultry v. Commissioner of Income tax, reported

in (2001) 9 SCC 740, held, in context of section 80I, that it was not possible to conclude that the dressing of poultry is tantamount to manufacture. In Commissioner of Income Tax v. Gem India Manufacturing Co., reported in 249 ITR 307, the Supreme Court held in context of Section 80I, that there can be little difficulty in holding that the raw and uncut diamond is subjected to process of cutting and polishing which yields the polished diamond, but that is not to say that the polished diamond is a new article or thing which is the result of manufacture or production. In C.I.T. v. Venkateswara Hatcheries (P) Ltd., reported in (1999) 3 SCC 632, the Supreme Court, in context of sections 80HH, 80HHA, 80I and 80J, held that the business of the assessee who was having poultry farms and running a hatchery where eggs were hatched on a large scale by adopting latest scientific and technological methods was not an industrial undertaking nor was it engaged in the business of producing "articles or things" and therefore, the assessee was not entitled to deductions under the said provisions. The Supreme Court in paragraph 17 of the judgement demonstrated how activity of the assessee was not an activity of production of any article or thing in the following terms;

> "From a perusal of the self-stated steps taken by the assessee for the alleged production of chicks, it is clear that the assessee does not contribute to the formation of chicks. The formation of chicks is a natural and biological process over which the assessee has no hand or control. In fact, what the assessee is doing is to help the natural or biological process of giving birth to chicks. The chicks otherwise can also be produced by conventional or natural method and in that process also, same time is taken when the chicks come out from the eggs. What the assessee by application of mechanical process does in the hatchery is to preserve and protect the eggs at a particular temperature. But the coming out of chicks from the eggs is an event of nature. The only difference seems to be that by application of mechanical methods, the morality rate of chicks is less and the assessee may get chicks more in number. This, however, would not mean that the assessee produces chicks and that chicks are "articles or things". We are, therefore, of the opinion that the assessee is neither an industrial undertaking nor does the business of hatchery carried out by the assessee

fall within the meaning of section 32-A and Section 80-J of the Act."

In the present case, application of mechanical methods only removed the steel plates and other objects which were existing on the ships, which would not mean that the assessees produced those existing articles or things by the process of removing and cutting them.

27.1 As held by the Supreme Court in C.I.T. v. N.C.Budharaja (supra), the word "production" or "produce" when used in juxtaposition with word "manufacture" takes in bringing into existence new goods by a process which may or may not amount to manufacture. It was held that the principle of adopting a liberal interpretation which advances the purpose and object of beneficial provisions cannot be carried out to the extent of doing violence to the plain and simple language of the enactment.

27.2 We are, therefore, unable to subscribe to the view that ship breaking is an activity which gives rise to manufacture and production of altogether new commercial articles or things. We hold that the assessees are, not entitled to claim deductions under Sections 80HH and 80I of the Act and that the Tribunal committed an error in upholding such deductions.

VI. DECISION:

28. For the foregoing reasons, we decide the above questions of law formulated in these appeals as under:

[1] The usance interest paid by the assessees was not any part of the purchase price of the ships and was interest within the meaning of the definition of the term `interest' under Section 2(28A) of the Income Tax Act, 1961.

[2] The assessees who did not deduct tax at source under section 195(1) of the Income Tax Act, 1961 on the usance interest payable outside India and on which tax had not been paid, are not entitled to deduct the amounts of such usance interest in computing their income chargeable under the head "profits and gains of business of profession". The Tribunal was, therefore, wrong in deleting the disallowance under Section 40(a)(i) of the Act for failure on the part of the assessees to deduct tax at source, from usance interest paid to the non-residents, under Section 195(1) of the Act.

[3] The assessees being responsible for paying to the non-residents usance interest which was chargeable under the provisions of the Income Tax Act, 1961, were liable to deduct income tax thereon under section 195(1) thereof. The Tribunal was, therefore, wrong in holding that the usance interest partook the character of purchase price and therefore, not liable to deduction at source under Section 195(1) of the Act.

[4] Usance interest is `interest' within the meaning of the Article concerning taxation of interest in the relevant Double Taxation Avoidance Agreements. The Tribunal was, therefore, wrong in holding that usance interest was not `interest' as envisaged in the Double Taxation Avoidance Agreements.

[5] Ship breaking activity is not an activity for manufacture or production of any article or thing for the purposes of availing the benefit of deductions under Sections 80HH and 80I of the Income Tax Act, 1961. The Tribunal was, therefore, wrong in holding that the ship breaking activity gives rise to manufacture and production of altogether new articles or things and in allowing deductions under Sections 80HH and 80I of the Act to the assessees.

29. The impugned orders of the Tribunal to the extent they are challenged in these appeals are, therefore, hereby set aside. All the appeals are accordingly allowed with costs to be paid by the respondents assessees to the appellants, quantified at Rs.10,000=00 for each appeal.

30. The learned counsel appearing for the assessees, at this stage, pray for a Certificate of Fitness for appeal to the Supreme Court under Section 261 of the Income Tax Act, 1961. Though the learned counsel have in this group of matters dilated the questions involved with great emphasis, in our opinion, having regard to the clear provisions of the Act, the D.T.A.As. and the facts of the case there is no justification for issuance of any such certificate. We, therefore, can not accede to the request made by the learned counsel for the assessees for certificate of fitness. The prayer made for staying the operation of this order is not at all justified and is rejected.

[R.K.ABICHANDANI, J.]

[A.L.DAVE, J.]

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